Supreme Court, U.S.
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No.

In the

Supreme Court of the United States

WILLIAM H. SCHELL,
and RUBY G. SCHELL,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether 26 U.S.C. §7422(h), which bars claims for refund "attributable to" partnership items, denies the United States Court of Claims jurisdiction over partner-level refund suits for loss of their personal basis in a terminated partnership, which is an affected item.

2. Whether, as effective for the years at issue, 26 U.S.C. §6224(c) settlements comprehensively settled all of a partner's partnership items of the partnership for the year identified in the settlement as a matter of law or, alternatively, whether the scope of §6224(c) settlements is a mixed question of law and fact.

PARTIES TO THE PROCEEDINGS BELOW

The following were the parties to the proceedings below before the United States Court of Federal Claims and the Court of Appeals for the Federal Circuit:

William H. Schell,

Ruby G. Schell, and

the United States of America.

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OPINIONS BELOW

The opinion of the Federal Circuit is reported at *Schell v. U.S.*, 589 F.3d 1378 (Fed.Cir. 2009) ("*Schell*"). App. 1-13.[1] The opinion of the Court of Federal Claims is reported at 84 Fed. Cl. 159 (2008). App. 14-39.

The directly conflicting opinions are:

Petaluma FX Partners, LLC v. C.I.R., 591 F.3d 649 (D.C.Cir. Jan. 12, 2010), *Jade Trading, LLC v. U.S.*, 598 F.3d 1372 (Fed.Cir. Mar. 23, 2010), and *LeBlanc v. U.S.*, 90 Fed.Cl. 186 (2010), on appeal before the Federal Circuit at Docket No. 2010-5073, which hold a partner's affected item, basis-related refund claims cannot be raised in TEFRA partnership-level proceedings but must be raised at the individual partner level; and

Field v. U.S., 328 F.3d 58 (2nd Cir. 2003); *Prochorenko v. U.S.*, 243 F.3d 1359 (Fed.Cir. 2001); and *Monti v. U.S.*, 223 F.3d 76 (2nd Cir. 2000), which hold the §7422(h) jurisdictional bar should be narrowly and literally construed and applied to only refunds directly

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[1] References to "App. x" are to page "x" of the attached Appendix.

attributable to partnership items and does not bar affected item refund claims.

Schell is also in indirect conflict with the authorities discussed below.

JURISDICTION

The judgment of the Federal Circuit was filed on December 22, 2009. App.2. The Schells' Combined Petition for Panel Rehearing and Rehearing *en banc* was denied April 8, 2010. App. 132. This Court has jurisdiction under 28 U.S.C. §1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The relevant constitutional provisions, statutes, and regulations are set forth in the appendix to this petition. App. 135-164.

STATEMENT OF THE CASE[2]

1. Summary

In the early 1980s, American Agri-Corp, Inc. ("AMCOR") organized over 200 limited partnerships. William H. Schell invested in two AMCOR partnerships: Canyon Desert Vineyards ("CDV") and Vista-Ag Realty Partners ("VARP").

In the late 1980s, the IRS examined some of the AMCOR partnerships. Those examinations and this suit are subject to the TEFRA[3] unified partnership examination procedures. The IRS proposed adjustments to partnership tax items of 43 AMCOR partnerships, including CDV (for 1985) and VARP (for 1986). Petitions challenging the adjustments were filed in the United States Tax Court. Barring other exceptions not at issue here, *arguendo*, the

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[2] Unless otherwise stated, references to "Section," "sec.", "§" are to sections of the Internal Revenue Code at 26 U.S.C. (the "Tax Code").

[3] Partnership procedures codified at 26 U.S.C. §§6221-6233 by the Tax Equity and Fiscal Responsibility Act of 1982, Pub.L. No. 97-248, 96 Stat. 324 ("TEFRA"). Effective for tax years after September 3, 1982. *See generally Maxwell v. C.I.R.*, 87 T.C. 783 (1986).

Schells were parties to the CDV and VARP Tax Court suits.[4]

While those suits were pending, the IRS solicited partnership item settlements from the AMCOR partners purportedly subject to the Tax Court suits. The Schells accepted the IRS's solicitation and settled their CDV 1985 and VARP 1986 partnership items. Also while the Tax Court suits were pending, CDV and VARP dissolved and terminated.

When the IRS notified the settled partners of their personal liability from their settlements, it also notified them that they could file a refund claim related to their loss of basis in their partnerships. The Schells followed the IRS's instructions and filed claims related to CDV and VARP – a first claim based on capital treatment of the loss of basis for VARP and two subsequent claims for ordinary loss treatment for CDV and the difference between capital loss treatment and ordinary loss treatment for VARP.

After the Schells settled and filed their basis claims, the IRS filed motions to enter agreed decisions in the CDV and VARP

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[4] Ruby G. Schell is a party only because she filed joint tax returns with her husband.

partnership-level suits. App. 165-169. The Tax Court entered those agreed decisions.

The IRS paid the Schells' first claim but denied the two subsequent claims. The Schells filed suit in the Court of Federal Claims on those denials. That court granted the Government's motion to dismiss for lack of jurisdiction pursuant to §7422(h), which bars partner-level refunds attributable to partnership items – even though basis is an affected item. The Schells appealed to the Federal Circuit, which affirmed the dismissal. The Schells petition this Court for review.

2. TEFRA Overview

Partnerships generally do not pay income tax; they file information returns.[5] Each partner recognizes his share of partnership income, gains, losses, deductions, etc., on his individual return.[6] Before 1982, to adjust an item reported on a partnership's return, the IRS separately examined each partner's return and could not ensure consistent treatment of items on the partnership return. Congress

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[5] *Conway v. U.S.*, 50 Fed.Cl. 273, 276 (2001).

[6] §§701, 702, 6031; Treas.Reg.§1.701-1; 1.702-1(a); 1.6031-1.

enacted TEFRA to consolidate some partnership audit and adjustment procedures.

At the heart of TEFRA are the mandatory, mutually exclusive categories of "partnership items" and "nonpartnership items" for which, for the pre-1997 tax years in issue, TEFRA bifurcates the procedures for adjustments, assessments, and refunds.[7]

a. Partnership Item Jurisdiction

"Partnership items" are:

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle [F], such item is more appropriately determined at the partnership level than at the partner level.[8]

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[7] See *Callaway v. C.I.R.*, 231 F.3d 106,107-113 (2nd Cir. 2000) and *Weiner v. U.S.*, 389 F.3d 152, 154-55 (5th Cir. 2004). This bifurcated system was substantially amended, effective for tax years beginning after August 5, 1997. Taxpayer Relief Act of 1997, P.L.105-34 §§1238(b) and 1239(b).

[8] §6231(a)(3). App. 150.

TEFRA (a.k.a. subchapter 63C of the Tax Code) mandates that partnership items be determined before nonpartnership items and allows for centralized adjustment of partnership items at the partnership level.[9] To adjust a partnership item, the IRS must first issue a Notice of Final Administrative Adjustment ("FPAA").[10]

Judicial review of an FPAA is limited to a single partnership-level suit. For pre-1997 tax years, jurisdiction in that proceeding is expressly restricted to the readjustment and allocation of partnership items.[11]

Generally, all partners are deemed parties to the partnership-level suit.[12] App. 140. But

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[9] §§6216(4), 6221, 6223, 6224(c), 6225(a), 6226, 6230(a)(1), 6231(a)(3); Temp.Treas.Reg. §301.6221-1T(a); *Callaway*, 231 F.3d at 110.

[10] §§6223(a)(2) and (d)(2). App. 137.

[11] §§6226(a), (b), and (f). App. 140-143. Most partnership-level suits are filed in the Tax Court, though they may also be filed in a federal district court or the Court of Federal Claims. §6226(a). App. 140-141. *E.g.*, *see AD Global Fund v. U.S.*, 67 Fed.Cl. 657 (2005).

[12] §6226(c).

two categories of partners are expressly barred: 1) those whose partnership items have converted to nonpartnership items (usually by settlement or bankruptcy), and 2) those whose assessment period has expired.[13] Because they cannot participate, they cannot be bound by the partnership level suit.[14]

Only partners with an interest in the outcome can participate in the partnership-level suit.[15] Under the Tax Court's Rules, "participating partners" are those who file either the petition or a notice of election to participate.[16] A partner's status as "participating" or "nonparticipating" is relevant only to certain notice requirements

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[13] §6226(d)(1)(A) and (B). App. 142.

[14] §§6226(d) and 6228(a)(4)(B); Tax Court Rules 245(b) and 247(a). App. 142,144,162. IRS Field Service Advisory 199950008, 1999 WL 1208429, December 17, 1999 (settled partners are no longer parties to the partnership-level proceedings).

[15] §6226(c) and (d). App. 142.

[16] Rules 245(b) and 247(b). App. 162.

and whether he may actively participate; it is irrelevant to the Tax Court's jurisdiction.[17]

After the partner's partnership items are determined, *e.g.*, by a partner's settlement (as here), the IRS can assess any resulting tax against that partner. In any later partner-level proceeding, those partnership item determinations are *res judicata*. They can be applied but cannot be challenged by the partner or the IRS.[18]

Accordingly, §7422(h) bars jurisdiction over any "refund attributable to partnership items (as defined in §6231(a)(3)) except as provided in section 6228(b) or section 6230(c)." App. 155. Section 7422(h) bars *only* refunds attributable

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[17] *E.g.*, (i) electing to participate cannot confer personal jurisdiction over or standing on a partner who is barred by §6226(d)(1)(B), (ii) nonparticipating partners are, nonetheless, bound by the outcome of the partnership-level suit, and (iii) §6226(d)(1)(A) terminates jurisdiction upon settlement or bankruptcy regardless of whether the partner participates.

[18] §§6224(c), 6226(g) and (h), 7422(h). App. 138, 143, 155. *Jade Trading,* 80 Fed.Cl. 11, 42 n.62 (2007) ("An affected item is a nonpartnership item but to the extent a determination of a partnership item affects the item, the determination at the partnership-level is conclusive at the partner-level.").

to partnership items. Section 6230(c) allows jurisdiction over refunds otherwise barred by §7422(h) on certain grounds, including that the IRS failed to make a credit or refund attributable to the application of a settlement.[19]

b. Nonpartnership Item and Affected Item Jurisdiction

A nonpartnership item is any "item which is (or is treated as) not a partnership item."[20] After the partner's partnership items are determined, that partner's *non*partnership items are then addressed, usually under the normal subchapter B deficiency procedures.[21] There are two types of nonpartnership items: pure nonpartnership items and affected items.

Pure nonpartnership items are items completely unrelated to the partnership, *e.g.*, rental income from property unrelated to the

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[19] §6230(c)(1)(B).

[20] §6231(a)(4). App. 150.

[21] *Maxwell*, 87 T.C. at 788; *Callaway*, 231 F.3d at 108, 110; §6230 (subchapter N non-TEFRA procedures – §§6211-6216 – apply to assessments attributable to nonpartnership/affected items that cannot be assessed by means of computational adjustments.).

partnership. Adjustments to partnership items do not alter pure nonpartnership items. Pure nonpartnership items are never addressed in a partnership-level proceeding and can only be addressed at the partner level.

Affected items are "any item to the extent such item is affected by a partnership item."[22] They have partnership- and nonpartnership-item components and, therefore, cannot be determined solely at the partnership level.[23] If the nonpartnership-item component is determined solely by math, *e.g.*, medical deductions, Treas.Reg. 6231(a)(6)-1T(a) allows assessments by "computational adjustment."[24] But if the item requires partner-level determinations, the tax cannot be assessed unless the IRS first issues a subchapter B

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[22] §6231(a)(5). App. 150. The statute makes it clear and it is well settled that *some* affected items have a partnership item *component*. *See N.C.F. Energy v. C.I.R.*, 89 T.C. 741, 743-4 (1987).

[23] *See Olson v. U.S.*, 172 F.3d 1311, 1317-18 (Fed. Cir. 1999), *citing N.C.F. Energy*, 89 T.C. at 744. See *Petaluma* and *Jade Trading*.

[24] §§6230(a) and 6231(a)(6). App. 148, 150.

deficiency notice.[25] Even if a deficiency attributable to an affected item can be assessed by computational adjustment, the affected item itself can be determined *only* at the partner level; it cannot be determined at the partnership level. Consequently, partner-level jurisdiction over the affected item cannot be foreclosed simply because a partnership-item component was previously determined at the partnership level.

It is well settled that a partner's basis in his partnership interest is an affected item, not a partnership item.[26]

3. Facts and History of This Case

William H. Schell invested in CDV for tax years 1985-1993 and VARP for tax years 1986-1995. In 1985 and 1986, CDV and VARP reported farming expense and other deductions. Schell reported his pro rata share

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[25] §6230(a)(2) and Treas.Reg. 6231(a)(6)-1T(a). App. 148.

[26] *Dial U.S.A., Inc., v. C.I.R.*, 95 T.C. 1, 5-6 (1990) (basis is not a partnership item because it is not required to be taken into account for the taxable year under subtitle A); *Univ. Heights at Hamilton Corp v. C.I.R.*, 97 T.C. 278, 281-282 (1991) (basis is an affected item because a partner's basis is partially comprised of partnership items, such as debt).

of the deductions on his 1985 and 1986 tax returns, as applicable. Subsequently, the Schells reported and paid tax on income passed through to them from CDV and VARP until those partnerships terminated in 1993 and 1995, respectively.

In 1990 and 1991, the IRS issued FPAAs to VARP (for 1986) and CDV (for 1985). The FPAAs proposed to completely disallow each partnerships' deductions. Among the IRS's shotgunned, alternative reasons to entirely disallow the deductions was that "[t]he partnership's activities constitute a series of sham transactions" and "[t]he partnership's activities lack economic substance." Petitions challenging the adjustments were filed in the Tax Court. Unless otherwise excepted and asserting *arguendo* for purposes of the petition for *certiorari*, the Schells were parties to the CDV and VARP partnership-level Tax Court suits.

In April 1997, while the Tax Court suits were pending, the IRS invited the partners to settle on substantially identical IRS-promulgated Forms 870-P(AD) that differed only by partnership as to the tax year and amount of deduction allowed. No grounds for the agreed adjustments were specified. Roughly half the AMCOR partners settled,

including the Schells. Their settlements allowed 45% of CDV's 1985 deductions and 50% of VARP's 1986 deductions. App. 170-175. The IRS assessed tax and interest. The Schells paid in full.

The partnership items of a settled partner become nonpartnership items on settlement and the partner is no longer a party to the partnership-level proceedings.[27] In numerous Tax Court Rule 248(c) notices filed in the Tax Court suits, the IRS represented that "pursuant to section 6231(b)(1)(C), such partnership items became nonpartnership items as of the date the settlement agreement was executed on behalf of Respondent and, pursuant to section 6226(d)(1)(A), [the partner] is no longer a party to the proceeding." Because they did not enter an individual appearance in the CDV and VARP suits, the Schells were not "participating partners" and the IRS was not required to and did not file Rule 248(c) notices for them.

As discussed in the Supplement to Combined Petition for Panel Rehearing and Rehearing *En Banc* for *Schell* mailed to the

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[27] §6224(c)(1) and (2), Temp.Treas.Reg. §301.6224(c)-3T(a) and (b) (effective for pre-1997 tax years), §6231(b)(1)(C), and §6226(d)(1)(B).

Federal Circuit and served on the government on February 25, 2010, in July and September of 2001, the Government filed two substantively similar cross-motions for summary judgment in *Weiner v. U.S.* (SDTX 00-1297) and *Matthews* (SDTX 00-4131) in which the Government admitted that it was "the IRS's intent that the settlement agreements . . . would represent a comprehensive and final settlement" and "[o]ther partners chose not to settle and remained parties to the partnership-level proceedings in the Tax Court." These judicial admissions are consistent with the Government's representations to the Fifth Circuit in *Duffie*[28] that "[a]s the [partnership-level Tax Court] litigation wore on, some partners entered into individual [Form 870-P(AD)] settlement agreements with the IRS, thereby terminating their status as parties to the litigation. ... *See* I.R.C. §§6226(d)(1)(A), 6231(b)(1)(C). ...."

As a part of the assessment procedure following the settlements, the IRS notified the settled partners that they were entitled to claim their loss of basis in their partnerships and instructed them how to claim that loss.

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[28] *Duffie v. U.S.*, 600 F.3d 362 (5th Cir. 2010).

Taxpayers are allowed "a deduction [for] any loss sustained during the taxable year and not compensated for by insurance or otherwise."[29] The deduction is limited to losses incurred in a trade or business, or as relevant here, "in any transaction entered into for profit . . . ."[30] Under Rev.Rul. 93-80, the Schells were entitled to deduct, in the year each partnership terminated, an amount equal to their personal basis in CDV and VARP minus any distributions they received on termination. They received no distribution on either termination.

In February 1998 the Schells filed a claim for tax year 1995, requesting a refund based on capital loss treatment of their loss in VARP. The IRS paid the claim and issued their refund in December 1998.

In 1999, the Schells filed a refund claim for the tax year 1993 and a second refund claim for the tax year 1995, claiming ordinary loss treatment for their losses on CDV's and VARP's terminations. Their 1995 claim requested only the difference between ordinary

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[29] §165(a).

[30] §165(a).

loss treatment and their prior capital loss treatment.

Almost three years after the settlements, IRS Special Trial Attorney Alice M. Harbutte instructed the IRS's TEFRA Technical Unit to compute and pay as capital losses the then-pending 2000 AMCOR related basis claims using the tax liability that resulted from the settlement as the amount of lost basis. App. 176-179. Harbutte also instructed the IRS that the claims should be paid under §6230(c)(1) because the IRS failed to allow a refund attributable to the application of a settlement. App. 177-178.

Harbutte's shorthanded basis calculation closely approximated most partners' actual ending basis and avoided complex, time consuming calculations necessary to determine each partner's actual ending basis – usually 10 years of calculations for each partnership. The Schells' claims referenced and incorporated that shorthand explanation but were clearly based on the Schells' final basis. The record reflects that the Schells took into account the net partnership income reported in subsequent years.

In 2001, pursuant to Tax Court Rule 248(b)(1)(B), the Tax Court granted the IRS's motions for entry of agreed decisions in the

partnership-level suits. The decisions recited that the adjustments to partnership income and expense were "attributable to" transactions "which lacked economic substance . . . so as to result in a substantial distortion of [partnership income and/or expense]." App. 166, 169.

In 2002, the IRS rejected the Schells' second, ordinary loss refund claim for 1995, informed them that AMCOR claims were to be treated as capital losses, and included instructions for claiming those losses. The IRS never acted on the 1993 claim.

Under 28 U.S.C. §1346(a) and §1491(a), the Schells filed suit on their claims in the Court of Federal Claims. The government filed a motion to dismiss, arguing lack of subject matter jurisdiction under §7422(h) or, alternatively, that the Schells failed to state a claim under Court of Federal Claims Rule 12(b)(6). The court granted the Government's motion, holding that the losses in the Schells' refund claims concern partnership items, which the Schells lack standing to pursue under §7422(h) and that the §6230(c) exception did not apply because the 1997 settlement agreements did not alter the FPAA's findings that the activities of CDV and VAPR were sham

transactions and thus did not convert the partnership items to nonpartnership items.

The Schells timely appealed to the Federal Circuit under 28 U.S.C. §1295(a)(3). They argued their claims were not barred by §7422(h) because their refunds were attributable to their loss of tax basis – an affected item, not a partnership item. The Government did not dispute that basis was not a partnership item but argued instead that the refunds were, nonetheless, "attributable to partnership items" due to the "lack of economic substance" term in the Tax Court decisions. App. 166, 169.

Following a *de novo* review, the Federal Circuit affirmed the trial court, holding §7422(h) barred the Schells' claims and the §6230(c) exception did not apply. The Court relied on prior analysis in *Keener*[31] that §7422(h) turns on whether the refund claims are "due to, caused by, or generated by" a partnership item. The Federal Circuit accepted the Government's argument that (i) a sham transaction lacks economic substance and is not recognized for federal income tax purposes

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[31] *Keener v. U.S.*, 551 F.3d 1358 (Fed.Cir. 2009) ("*Keener* II"). The *Schell* court also relied on *Keener v. U.S.*, 76 Fed.Cl. 455 (2007)("*Keener* I").

and cannot be the basis for a deductible loss, (ii) the Schells' refund claims were based on the assertion that the partnerships' transactions were not shams, (iii) sham is a partnership item, and (iv) accordingly, the Schells' claims were attributable to partnership items and barred by §7422(h).

The Federal Circuit further held §6230(c)(1)(B) did not except the refunds from the §7422(h) jurisdictional bar because §6231(b)(1)(C) converts a settling partner's partnership items to nonpartnership items only "with respect to such [settled] items." Citing *Keener* I, the court rejected the Schells' legal argument that Temp.Treas.Reg. §301.6224(c)-3T(b), in effect for the years at issue, required §6224(c) settlements like the Form 870-P(AD) settlements to comprehensively settle all partnership items for the identified tax year. The court held the settlements were partial and left the character of the farming transactions for resolution by the agreed decisions. *Schell* did not address the IRS's numerous representations and admissions to the partners, the Tax Court, the Southern District of Texas, and the Fifth Circuit that these settlements were comprehensive. Nor did the opinion address the IRS's internal instructions that the

partner's basis claims would be allowed pursuant to the §6230(c) exception.

The Federal Circuit also rejected the Schells' argument that allowance of 45-50% of the partnership deductions was inconsistent with a sham/lack of economic substance determination, which results in total disallowance of the transaction. The Court was persuaded that the IRS's decision to settle did not mean it conceded the transactions were not shams and just because the FPAAs listed "sham transaction" as one of the many alternative grounds for disallowing the transactions did not render the FPAAs less conclusive.

Ultimately the Federal Circuit relied on its interpretation of the character of disallowed farm losses in the agreed decisions to make its jurisdictional determination. The court's approach conflated the merits of the claims with whether the court could hear those merits and turned affected-item jurisdiction into an *ad hoc* determination based the court's estimation of the likelihood that the Schells would prevail given the "lack of economic substance" term in the subsequent agreed decisions – all without actually considering the Schells' claim.

Schell did not address the partner's argument that, even *arguendo* if their settlement was "partial," the character of the disallowed farm losses was, nonetheless, converted to a nonpartnership item on entry of the Tax Court decision. As such the character of those items was no longer a partnership item and a refund claim based on the application of the agreed decision would not have been barred by §7422(h).

REASONS TO GRANT THE PETITION

The issue in *Schell* is whether the Federal Circuit erred in dismissing the partners' basis claims for lack of jurisdiction under §7422(h). But *Schell* illustrates a broader uncertainty as to TEFRA partnership item and affected-item jurisdiction.

This jurisdictional uncertainty affects millions of partnerships and individual partners. As explained in the *amicus curiae* brief filed by SRK Wilshire Partners in *Curr-Spec*,[32] there are over three million private companies doing business as various forms of

[32] *Curr-Spec Partners, L.P., v. U.S.*, S.Ct.Docket No. 09-871, *cert* denied — S.Ct. — , 2010 WL 265882 (May 24, 2010)

partnership entities.[33] Each of those entities has multiple partners. Virtually all of those entities and their individual partners are subject to TEFRA and directly impacted by this jurisdictional uncertainty.

This jurisdictional uncertainty is easily illustrated by the ACMOR-related refund claims. Following settlements with some partners of only 43 partnerships, over 2000 AMCOR basis claims were filed with the IRS by January 6, 2000 (two years prior to entry of the agreed decisions). Of the three AMCOR-related basis claims that have been judicially reviewed (including *Schell*), there have been three different jurisdictional outcomes. AMCOR partners also filed hundreds of claims on other grounds, *e.g.*, §6621(c) and limitations. Eleven of those claims have been judicially reviewed with ten different jurisdictional outcomes. As discussed above, there are approximately 100 pending AMCOR-related claims that await coherent, consistent jurisdictional guidance.

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[33] The IRS received 3,307,000 partnership returns for 2008. IRS Data Book Table 2, Number of Returns Filed, by Type of Return, Fiscal Years 2007 and 2008, http://irs.gov/pub/irs-soi/08db02nr.xls.

Schell is also only one of many recent TEFRA jurisdictional determinations. As discussed below, the conflicts between recent decisions and established precedent are both inter- and intra-Circuit.

The *ad hoc* approach to TEFRA jurisdiction illustrated by *Schell* has left similarly situated taxpayers with substantially identical claims with inconsistent jurisdictional outcomes. Taxpayers no longer have guidance, litigation has been needlessly multiplied, and the integrity of the tax system has been undermined by the fractures in TEFRA jurisdiction.

This petition raises a subsidiary issue for *certiorari*. In *Schell* the Federal Circuit found the Form 870-P(AD) settlements were partial and left the character of the farming expenses for later determination in the agreed decisions. That holding is at odds with Second and Eleventh Circuit precedent.[34]

This same uncertainty regarding affected item procedural issues will be addressed in a petition for *certiorari* to be filed by August 12, 2010, for *Duffie*. Should the Federal Circuit

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[34] *Fickling v. U.S.*, 507 F.3d 1302 (11th Cir. 2007); *Callaway*, *supra*.

deny the pending motions for rehearing in *Prati*[35] and *Deegan*, petitions for *certiorari* will be filed in each. Petitions for *certiorari* addressing this same partnership-item vs. affected item jurisdiction were filed but denied in *Weiner*, *Keener*, and *Curr-Spec*.[36]

1. AMCOR Related Basis Claims Have Been Treated Inconsistently

The IRS paid most of the 2000-plus AMCOR basis claims filed by January 6, 2000. But some partners were forced to file suit. Their claims are still pending, primarily in the Court of Federal Claims, the Federal Circuit, and various district courts of the Fifth Circuit. Three different courts have reviewed three AMCOR basis claims with three different jurisdictional outcomes.

In September 2002, Richard Nault filed AMCOR basis claims. He did not settle with the IRS and, presumably, remained a party to the partnership-level suits until the agreed decisions were entered. His claims were denied and he filed suit in the New Hampshire federal

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[35] *Prati v. U.S.*, 603 F.3d 1301 (Fed.Cir. 2010) ("*Prati* II").

[36] *Curr-Spec Partners, L.P. v. C.I.R.*, 579 F.3d 391 (5th Cir. 2009).

district court. The government did not dispute jurisdiction or raise §7422(h). In 2007, the district court denied his claims on the merits. Nault appealed to the First Circuit.[37] Deborah K. Snyder represented the United States. In February 2008, the First Circuit affirmed the merit-based determination.[38]

In 1999 the Schells filed their AMCOR basis claims. They filed suit in the Court of Federal Claims in 2000. They settled but the government asserted and the court held they were bound by the later Tax Court decisions. In December, 2008, their claim was dismissed pursuant to §7422(h). Deborah K. Snyder represented the Government before the Federal Circuit. In December of 2009, the Federal Circuit affirmed the dismissal.

In May 2002, the LeBlancs filed an AMCOR basis claim.[39] The LeBlancs also settled on IRS Form 870-P(AD)s. The Schells and LeBlancs share common tax counsel and filed substantially identical claims that differed only as to partnerships, tax years, and

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[37] *Nault v. U.S.*, 2007 WL 465310 (D.N.H.), unpublished.

[38] *Nault v. U.S.*, 517 F.3d 2 (1st Cir. 2008).

[39] *LeBlanc, supra.*

amounts. The LeBlancs filed suit in the Court of Federal Claims. The government moved for summary judgment, asserting §7422(h). The court rejected the government's jurisdictional argument, held the LeBlancs' basis claim was not barred by §7422(h), and denied the claim on the merits.

LeBlanc is inconsistent with *Schell* and *Keener* I, which *Schell* cited as authority. Judge Allegra issued both *LeBlanc* and *Keener* I. But in *LeBlanc* Judge Allegra followed the taxpayer's approach to affected-item jurisdiction that had been rejected in *Keener* I – partnership-level items are *determined* at the partnership-level and *applied* at the partner-level and §7422(h) does not bar claims that challenge the partner-level *application* of partnership-level determinations.

The LeBlancs appealed to the Federal Circuit. Deborah K. Snyder again represents the government. Although jurisdiction can be raised at any time, the government did not cross-appeal respecting jurisdiction. The LeBlancs' filed their opening brief June 30, 2010.

2. *Schell* Is Inconsistent With Other Recent Partnership-Related Basis Claims

In *Petaluma*, the D.C. Circuit construed basis claims from the other side of the jurisdictional divide – the partnership-level.

As in *Schell*, the government conceded outside basis is an affected item, not a partnership item, but argued nonetheless that the elements of basis are mainly or entirely partnership items and that the Tax Court had jurisdiction to make the allegedly "obvious conclusion" that a partner could not have any basis given the sham/lack of economic substance finding. The Tax Court found the partnership was a sham, lacked economic substance, and should be disregarded for tax purposes. The Tax Court further held, at the partnership-level, that the partners had no basis in the partnership. App. 94. §7422(h)

The D.C. Circuit affirmed as to sham/lack of economic substance but reversed as to basis. The court recognized that under §6226(f) only partnership items can be reviewed in a partnership-level suit and a partner's basis in his partnership ("outside basis") is an affected item not a partnership item. The court correctly determined the issue was not whether it was "obvious" that a sham/lack of

economic substance finding was fatal to the partners' basis claim – the issue was whether the Tax Court had jurisdiction to make the basis determination at all.

As the Court succinctly put it:

> The fact that a determination seems obvious or easy does not expand the court's jurisdiction beyond what the statute provides. *In other words, it does not matter how low the fruit hangs when one is forbidden to pick it.* We hold that the Tax Court had no jurisdiction to determine that Petaluma's partners had no outside basis in the disregarded partnership. Finally, we note that nothing about the concept of outside basis indicates that it is more appropriately determined at the partnership level. If disregarding a partnership leads ineluctably to the conclusion that its partners have no outside basis, that should be just as obvious in partner-level proceedings as it is in partnership-level proceedings. Moreover, with the invalidity of the partnership conclusively established as a partnership-level determination, there is little danger that outside basis will

> receive inconsistent treatment at the individual partner level.

App. 107-108. Emphasis added.

Shortly after *Schell* was entered, the Federal Circuit issued *Jade Trading*. In that partnership-level case the Court of Federal Claims held the partnership's transactions lacked economic substance and should be disregarded for tax purposes. Again the government asserted penalties based on the partners' outside basis could be determined at the partnership level because most (if not all) of the components of basis are partnership items, including the legal and factual determinations that underlie the characterization of partnership items as lacking economic substance. The trial court held for the government.

The Federal Circuit reversed as to the basis-related penalties, recognizing outside basis is an affected item that can only be determined at the partner level. App. 65-66. *Jade Trading* followed *Petaluma*, including the portion of the decision that explained §6230(c)(1) allows partners to challenge the *application* of the partnership-level, partnership-item determinations to their affected items.

The *Petaluma* and *Jade Trading* approaches to affected-item jurisdiction cannot be reconciled with *Schell*. Those cases were raised in the Schells' motion for rehearing, which was denied without comment.

3. TEFRA Bifurcated Partnership Item and Affected Item Jurisdiction Is A Recurring Issue

Other recent affected-item decisions have followed the *ad hoc* jurisdictional approach affirmed by *Schell* but rejected by *Petaluma* and *Jade Trading*.

a. Section 6621(c) Jurisdiction

Under §6621(c), now repealed but still effective for tax years 1982-1987, an underpayment of tax attributable to one of the tax motivated transactions listed in that statute and the accompanying regulation is subject to an enhanced interest rate. App. 153-154.

Since 1987, the Tax Court has consistently held it lacks jurisdiction to make a §6621(c) determination in a partnership-level proceeding because §6621(c) is not a

partnership item and not within the scope of a partnership-level proceeding.[40]

The Second and Fourth Circuits have likewise held §6621(c) interest is not a partnership item.[41] In *Field,* the Second Circuit recognized and accepted 20 years of precedent establishing §6621(c) is an affected item with both partnership and partner-level components. The Second Circuit expressly held §6621(c) refund claims are not barred by §7422(h).

Another AMCOR-related §6621(c) decision followed this well-settled approach to affected item jurisdiction – *Weiner*. There the government did not raise §7422(h) with respect to §6621(c). But, as discussed below, the government raised and the Fifth Circuit addressed §7422(h) with respect to the partner's limitations claim. Had that court considered §7422(h) to be a bar to §6621(c), the Fifth Circuit could have raised §7422(h) *sua sponte*. Instead the court followed established precedent that §6621(c) refund claims are

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[40] *N.C.F. Energy*, 89 T.C. at 744-5. See also *Affiliated Equip. Leasing II v. C.I.R.*, 97 T.C. 575, 576-78 (1991) (citing *White v. C.I.R.*, 95 T.C. 209, 212 (1990)).

[41] *Field*, 328 F.3d at 60; *Zfass v. C.I.R.*, 118 F.3d 184, 192 (4th Cir.1997).

brought at the partner-level and addressed the merits of the claim, holding the IRS improperly imposed §6621(c) against the settled AMCOR partners as a matter of law.

Like *Weiner*, partners in other AMCOR cases (*Keener*, *Prati*, and *Deegan*) and non-AMCOR cases (*McGann* and *Bartimmo*)[42] asserted the IRS misapplied settlements and/or partnership-level decisions and improperly imposed §6621(c) interest. In *Keener*, *Prati*, *McGann*, and *Bartimmo*, the government asserted later alleged partnership-level, partnership-item determinations were enough to jurisdictionally bar the partners' affected-item, §6621(c) claims – the "low hanging fruit" argument rejected in *Petaluma* and *Jade Trading* but adopted by *Schell*. That approach is not a true jurisdictional determination but a decision on the government's defense to the merits used to foreclose review of the partner-level claim. *Keener* I and *Prati* I and II adopted the government's argument and dismissed pursuant to §7422(h). *McGann* and *Bartimmo* rejected the government's argument and held for the partners on the merits.

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[42] *McGann v. U.S.*, 76 Fed.Cl. 745 (2007) (jurisdiction) and *McGann v. U.S.*, 81 Fed.Cl. 642 (2008) (merits); *Bartimmo v. U.S.*, 525 F.Supp.2d 879 (S.D.Tex. 2007).

This §6621(c) affected-item jurisdictional confusion exists in other non-AMCOR cases. In *River City Ranches*, the Ninth Circuit held the partnership-item components of §6621(c) are determined at the partnership-level. In *Ertz*, the Tax Court held *River City* barred partner-level jurisdiction over a partner-level, §6621(c) claim.[43] But on appeal *sub nom* in *Keller*,[44] the Ninth Circuit clarified that the partner-level court may and should address whether §6621(c) can be applied based on the partnership-level determinations.

In *Keller*, the Ninth Circuit was persuaded that barring partner-level, affected-item claims leaves taxpayers with no possible review of erroneously imposed §6621(c) penalty interest. In *Barlow* the Sixth Circuit similarly held the lack of a *pre*-payment forum (akin to a partnership-level proceeding) to challenge the improper or unsupported imposition of §6621(c) penalty interest does not violate taxpayer Fifth Amendment due process rights because taxpayers have a *post*-payment, refund forum.[45] Because of the limited scope of

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[43] *Ertz v. C.I.R.*, 93 T.C.M. (CCH) 696 (2007).

[44] *Keller v. C.I.R.*, 568 F.3d 710 (9th Cir. 2009).

[45] *Barlow v. C.I.R.*, 301 F.3d 714 (6th Cir. 2002).

partnership-level proceedings, *Schell* and other decisions that partake of the "low hanging fruit" to jurisdictionally foreclose affected-item claims have eviscerated that due process safety net and left partners with no forum for review of their affected item claims.

b. *Schell* Is Inconsistent With Second Circuit and Federal Circuit Precedent on the Scope of §7422(h)

Schell is inconsistent with Second Circuit and Federal Circuit §7422(h) precedent. In *Field*, the Second Circuit refused to expand §7422(h) to encompass claims for refund that are *capable* of being attributed to partnership items. The court reasoned §7422(h)'s plain language only bars jurisdiction if the refund itself (not the item which leads to that refund) is attributable to partnership items. App. 42-46. The Second Circuit was also persuaded that §7422(h)'s parenthetical reference to §6231(a)(3) strictly limited the jurisdictional bar to defined partnership items. App. 42.

In *Prochorenko*, the Federal Circuit followed *Monti*, another Second Circuit §7422(h) decision.[46] The *Prochorenko* court recognized

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[46] *Prochorenko*, 243 F.3d at 1363, citing *Monti*, 223 F.3d at 82.

that while the partner sought a refund of partnership-related taxes, the refund was not "attributable to" partnership items. The Federal Circuit adopted the Second Circuit's observation that "at some level of generality, most refund claims for partnership taxes can be characterized as a refund 'attributable to partnership items,' " and held that construing that phrase so broadly would be contrary to the system of separate treatment of partnership items and nonpartnership items established by Congress in TEFRA. App. 119-120. As *Prochorenko* and *Monti* realized, to some extent all affected item refund claims seek recovery of tax liability that is "attributable to" partnership items. But where the grounds for the refund are not based on the partnership item determination but on how that determination was applied to the partner (or on other independent grounds), then §7422(h) does not bar the claim.

c. Jurisdictional Precedent Is Also Split Regarding Statutes of Limitations

For the pre-1997 tax years in issue, §6501(a) states:

> [T]he amount of any tax imposed by this title shall be assessed within 3 years after the return is filed ....

App. 152.

For the pre-1997 tax years in issue, §6229(a) states:

> [T]he period for assessing any tax imposed by subtitle A . . . which is attributable to any partnership item (or affected item) for the partnership taxable year shall not expire before the date which is 3 years after ... the date on which the partnership return for such taxable year was filed ....

App. 145.

Section 6501(a), with any applicable exceptions, is the IRS's general deadline for assessing taxes.

Until recently, it was unclear whether the IRS's deadline for assessments attributable to partnership items and affected items was solely §6501(a), solely §6229(a), or some combination, with any applicable exceptions. Multiple courts assumed that (i) §6229(a) was the sole statute of limitations for such assessments, (ii) §6229(a) and any §6229-based exceptions were partnership items that could

only be raised in partnership-level proceedings, and (iii) §7422(h) barred jurisdiction in partner-level suits over refunds attributable to §6229-based untimely assessments.[47]

In the last few years multiple courts have held that (i) §6501(a), with any applicable exceptions, is the only statute of limitations for assessments attributable to partnership items and affected items, and (ii) §6229(a), with any applicable extensions, is merely one of the possible exceptions to §6501(a).[48] The courts, as best articulated by the Fifth Circuit in *Curr-Spec*, now recognize that Congress never intended a partnership-wide assessment deadline but instead left the assessment

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[47] *See Chimblo v. C.I.R.*, 177 F.3d 119, 125 (2d Cir.1999); *Kaplan v. U.S.*, 133 F.3d 469, 473 (7th Cir.1998); *Williams v. U.S.*, 165 F.3d 30 (6th Cir.1998) (unpublished table decision); *Barnes v. U.S.*, No. 95-57-Civ-ORL-22, 1997 WL 732594, *3 (M.D.Fla. July 25, 1997), *aff'd*, 158 F.3d 587 (11th Cir.1998); *Thomas v. U.S.*, 967 F.Supp. 505, 506 (N.D.Ga.1997); *Slovacek v. U.S.*, 36 Fed.Cl. 250, 255 (1996); *Weiner*, 389 F.3d at 155-159; *Keener* II, at 1362-64.

[48] *Rhone-Poulenc Surfactants & Specialties, L.P. v. C.I.R.*, 114 T.C. 533, 542-43 (2000) (*en banc*); *Andantech LLC v. C.I.R.*, 331 F.3d 972 (D.C. Cir. 2003); *AD Global Fund v. U.S.*, 481 F.3d 1351 (Fed.Cir. 2007); *Curr-Spec*, 579 F.3d at 398.

deadlines partner-specific, *i.e.* the IRS's deadline to assess related to common partnership items can be different for every partner.[49]

It is undisputed that §6229(a) and any §6229-based exception are partnership items. Whether or when a partner filed his return (*i.e.* §6501(a)) cannot be a partnership item because it is not "required to be taken into account for the partnership's taxable year" and the IRS never prescribed by regulation that it "is more appropriately determined at the partnership level than at the partner level." No court has ever held it is a partnership item. The Government has never disputed it is a nonpartnership item. Twenty-five years of precedent, as recently reiterated by the D.C. Circuit in *Petaluma* and the Federal Circuit in *Jade Trading*, holds that any item with both partnership item (*e.g.*, §6229) and nonpartnership item (*e.g.*, §6501(a)) components is an affected item, not a partnership item. Therefore, under the established affected item analysis, the statute of limitations to assess against any partner a deficiency attributable to partnership items or affected items is itself an affected item.

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[49] *Curr-Spec*, 579 F.3d at 399.

Under TEFRA's established affected item analysis, for pre-1997 tax years a partner can raise his §6501(a) limitations defense to assessment only in a partner-level refund suit. There, the court has jurisdiction to *determine* nonpartnership item components and *apply* partnership-item components previously determined in any partnership-item proceeding binding on him.[50] Section 7422(h) bars jurisdiction over only refunds "attributable to partnership items." Therefore, because the limitations period to assess is an affected item, §7422(h) cannot bar jurisdiction in a partner-level refund suit over a limitations-based claim.

But rather than follow the standard affected-item analysis in limitations cases, the courts are fracturing that jurisdictional structure. In *Prati*, the Federal Circuit never

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[50] Courts and practitioners are simply wrong when they say partnership items must be determined uniformly as to all partners. As here, partners can settle their partnership items in partner-level agreements binding only on that partner and the IRS. In partner-level refund suits courts can *apply* any previously made partnership-item determinations binding on that partner, regardless of whether those determinations were made at the partnership- or partner-level.

denied that §6501(a) is a nonpartnership item.[51] Instead, it held §§6501 and 6229 "operate in tandem to provide a single limitations period" that is a partnership item, not an affected item.[52] It also held that partners in refund suits for pre-1997 tax years can assert both the §6501-based and §6229-based components only in partnership-level suits and §7422(h) bars partners from raising their §6501(a)-based limitations defense in a partner-level refund suit.

This is problematic because in partnership-level suits for pre-1997 tax years, (i) §6226(d)(1)(B) unambiguously bars personal jurisdiction over and standing to any partner whose assessment period for that tax year has expired, and (ii) §6226(f) restricts subject matter jurisdiction to determining and allocating partnership items. But the Federal Circuit never disputes that §6501(a) is a nonpartnership item. To get around this problem, the Federal Circuit simply ignores the existence of pre-1997 §6226(d)(1)(B) and (f) to hold that the Tax Court had jurisdiction in the pre-1997 partnership-level AMCOR suits because the 1997 amendments to those

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[51] *Prati, supra.*

[52] *Id.* at 1307.

statutes "merely codified prior practice in the Tax Court."[53] But the Federal Circuit erred on the facts and the law. Before the 1997 amendments the Tax Court allowed such partners to participate but *only* to raise a partnership item component of their assessment deadline.[54] Before the 1997 amendments the Tax Court had *never* held that it had jurisdiction in a partnership-level suit to determine or allowed a partner to participate to raise any nonpartnership item component of his assessment deadline, such as §6501(a). Three years after the 1997 amendments the Tax Court – in a case where jurisdiction was undisputed by the parties – cited *Columbia Bldg.* as generally authorizing a partner to assert and jurisdiction for the Tax Court to address whether "the period of limitations for assessing any tax attributable to partnership items has expired ...."[55] But

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[53] *Id.* at 1307 n. 4.

[54] *Columbia Bldg., Ltd. v. C.I.R.*, 98 T.C. 607, 612 (1992) ("[W]e . . . conclude that [§6226(d)(2)] would not preclude petitioner from litigating a [§6229-based] statute of limitations defense which is applicable to ALL partners due to respondent's failure to issue a timely FPAA.").

[55] *Rhone-Poulenc*, 114 T.C. at 535.

even there, the issue was whether §6229-based partnership item components could extend the §6501(a) periods of *all* partners. No individual partner's §6501(a) assessment deadline was ever addressed, much less determined.[56]

Before *Prati* it was well settled that the Tax Court, as an Article I court, could exercise jurisdiction only to the extent expressly authorized by Congress.[57] Its jurisdiction could not be expanded by agreement of the parties or *sua sponte* by the court.[58]

With *Prati*, the systemic decay of TEFRA's procedures for determining affected items has reached Constitutional proportions, undermining the separation of powers. Article I, Section 8, Clauses 1 and 9 authorize Congress to "lay and collect Taxes" and "constitute Tribunals inferior to the supreme

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[56] *Id.* at 539-558.

[57] §§7441 and 7442 [App. 155-156]; *Continental Equities, Inc. v. C.I.R.*, 551 F.2d 74 (5th Cir. 1977); *C.I.R. v. Gooch Milling & Elevator Co.*, 320 U.S. 418, 419-420 (1943); *Runtch v. C.I.R.*, 30 T.C.M. (CCH) 856, 858 (1971).

[58] *Correia v. C.I.R.*, 58 F.3d 468 (9th Cir. 1995) ("Subject matter jurisdiction in the Tax Court cannot be conferred by the parties' consent or waiver.").

Court." But in *Prati* the Federal Circuit now holds that the Tax Court may, as a matter of law and by its "mere practice," usurp the authority previously reserved to Congress and create for itself the exact personal jurisdiction, standing, and subject matter jurisdiction that Congress expressly, unambiguously, and flatly banned by statute.

Prati's simplistic approach to avoid the proper affected item jurisdictional analysis for limitations has now been adopted, without analysis, by at least one district court.[59] The limitations issue is not present in *Schell*, but it is in *Prati* and *Deegan* and petitions for *certiorari* will be filed if the Federal Circuit denies the pending petitions for rehearing.

d. *Schell* Fails to Defer to the IRS's Reasonable Interpretation of Temp.Treas.Regs. §301.6224(c)-3T(a), (b) and Is In Conflict With the Second Circuit's Affirmation of the IRS's Interpretation

Like all tax settlements, a Form 870-P(AD) is a contract construed under general contract

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[59] *Matthews v. U.S.*, 2010 WL 2305750 (S.D.Tex. June 8, 2010), appealed to the Fifth Circuit at 10-20425.

law.[60] But the Schells' Form 870-P(AD), like all Forms 870-P(AD), plainly states on its face that it is a settlement pursuant to §6224(c). Section 6224(c) creates two types of interdependent settlement agreements that are uniquely governed by statute and regulation as well as contract law.

Under §6224(c)(1), an "original settlement" of partnership items between the IRS and a partner "shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year." If the IRS enters into a §6224(c)(1) original settlement, then under §6224(c)(2) other partners have a right to enter into a "consistent agreement" on "terms for the partnership taxable year which are consistent with those contained in such settlement agreement."

As effective for pre-1997 tax years, Temp. Treas.Reg. §301.6224(c)-3T(b) provided

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[60] See *Busing v. U.S.*, 47 Fed.Cl. 621, 629-30 (2000), citing *Treaty Pines Inv. Partnership v. U.S.*, 967 F.2d 206 (5th Cir., 1992) and *Goldman v. C.I.R.*, 39 F.3d 402, 405 (2d Cir.1994) (tax settlement agreement (Form 870-AD) must be construed using general principles of a contract law).

§6224(c) consistent settlements "shall be comprehensive, that is, a settlement may not be limited to selected items." In *Greenberg*, the *IRS* asserted and the Tax Court held that the §301.6224(c)-3T(b) "comprehensive" language applied to original and consistent settlements and meant that both comprehensively settle *all* partnership items for the tax year.[61] In *Cinema '84*, the Second Circuit affirmed the IRS's interpretation of the regulation was reasonable.[62]

That interpretation was consistent with the IRS's official position at the time of these settlements. The IRS distinguished between §6224(c) settlements, which must comprehensively settle all partnership items for the tax year, and other settlements such as §7121, Form 906 Closing Agreements, which it recognized could be partial but it discouraged due to difficulties in calculating and tracking limitations.[63] The IRS instructed its litigating

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[61] *Greenberg Bros. #4 v. C.I.R.*, 111 T.C. 198, 206 (1998), *aff'd sub nom. Cinema '84 v. CI.R.*, 294 F.3d 432 (2nd Cir. 2002).

[62] *Cinema '84*, at 439.

[63] See the IRS's Litigation Guideline Memorandum, 1990 WL 1086188, n.2 (IRS LGM), 1990 LGM TL-87 (6/04/90). At n.2 to the 1990 LGM, the IRS recognized

personnel that Temp.Treas.Reg. §301.6224(c)-3T(b) required both original settlements and consistent settlements to settle *all* partnership items for the tax year and "if a settlement agreement leaves any items to be litigated either at the time it is executed or at the time a request for consistent terms is made, it is our position that the agreement will not be subject to consistent settlement."

Effective October 4, 2001, three years after the Schells settled with the IRS, Temp.Treas.Reg. §301.6224(c)-3T(b) was replaced by Treas.Reg. §301.6224(c)-3,[64] which recognized partial §6224(c) settlements. But to the extent §6224(c) settlements could have been or now can be partial, §6224(c)(1) still prohibits partial settlements "except as otherwise provided in such agreement." The IRS has since issued specific instructions requiring promulgated forms to be conspicuously annotated "Partial Agreement"

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the difference between §6224(c) settlements, which it interpreted to be comprehensive, and other types of settlements that it acknowledged could be partial but should be cautiously entered into because of uncertainty as to limitations issues.

[64] 66 FR 50541-1, 50552-3, 2001-2 C.B. 344, 2001 WL 34028604 (October 4, 2001).

and contain a statement notifying the partner that he remains a party to the partnership-level proceeding for all unsettled partnership items."[65] The *Schell* Forms 870-P(AD) do not in any way state they were partial.

Schell followed and cited *Keener* I which held, contrary to the IRS's interpretation affirmed by the Second Circuit in *Cinema '84*, that the regulation meant consistent settlements must comprehensively agree to all the partnership-item terms in the original settlement and cannot be limited to only some of the original settlement terms. *Schell* did not follow *Keener* II, in which the Federal Circuit noted that the AMCOR Forms 870-P(AD) comprehensively settled all of that AMCOR partner's partnership items then before the Tax Court, thereby removing the partner from the partnership-level proceeding.[66]

Even though the scope of §6224(c) settlements is largely controlled by law, the facts of this case are overwhelming and uncontroverted and prove the Schells'

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[65] IRS Non Docketed Service Advice Review, 2002 WL 32167989 (IRS NSAR), 2002 IRS NSAR 20,301 (August 13, 2002).

[66] *Keener* II, at 1360.

settlements were comprehensive. *Schell* erred on the facts of the case and erred in granting summary judgment for the government.

The Government did not wait for the allegedly unresolved character of the partnership items to be determined by the Tax Court or rely on the alleged "findings" in those decisions. The IRS assessed tax immediately after the settlements and notified the partners they could file basis claims at the same time it sent its calculations of the liability that resulted from the settlements – which was years before entry of the agreed decisions.

In the Rule 248(c)(1) notices filed contemporaneously with the settlements, the IRS represented to the Tax Court that the AMCOR Form 870-P(AD) settlements addressed the partners' "partnership items for the [1986] partnership taxable year ..., which is the subject of this proceeding" and, pursuant to §6231(b)(1)(C), the partners' partnership items became nonpartnership items as of the date of the settlement and those participating partners were "***no longer a party to the proceeding.***" The IRS's statements were unqualified and unequivocal – partners who entered into the Form 870-P(AD) settlements were no longer parties to the Tax Court cases for any reason.

The government repeated that comprehensive settlement admission in its dispositive motions filed with the federal district court for the Southern District of Texas in *Weiner* and *Matthews* and in its appellate brief in *Duffie*.

Finally, as a matter of simple logic the comprehensive nature of §6224(c) settlements must at a minimum apply to partnership items and their characterizations. *Schell* (*Keener* I and *LeBlanc*) split with the Eleventh Circuit and the Second Circuit on this issue. In *Fickling*, the Eleventh Circuit refused to allow a partner to later inconsistently recharacterize a settled item as a sham after the IRS had agreed to allow over half of the item. In *Callaway*, the Second Circuit established that a partnership-item determination is conclusive for all purposes and refused to allow the widow of a partner to treat partnership items inconsistently than they had been determined. Also, once a partnership item converts to a nonpartnership item, there is no "partnership item" character left – only the character of the now converted nonpartnership item exists.

If the Court should find in favor of jurisdiction, unless it is determined that the settlements were comprehensive as a matter of law, then summary judgment in favor of the

government should not be granted on that issue. The Schells produced overwhelming evidence that the settlements were comprehensive. The government, the moving party, did not respond to and wholly failed to rebut that evidence. The government should also be bound to its admissions and representations to various courts respecting the comprehensive nature of the settlements. Granting summary judgment in the government's favor on that issue without a trial to determine the scope of the agreement would violate the Schells' right to due process.

CONCLUSION

Review should be granted to address these significant issues as to the orderly administration of the tax laws and resolve the Circuit splits and disparate treatment of similarly situated taxpayers in affected item litigation. The affected item jurisdictional issue will be at the core of at least three additional petitions for certiorari expected to be filed this term.

Respectfully submitted.

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JULY 2010

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United States Court of Appeals for the Federal Circuit

2009-5010

WILLIAM H. SCHELL and RUBY G. SCHELL,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Thomas E. Redding, Redding & Associates, P.C., of Houston, Texas, argued for plaintiffs-appellants. With him on the brief were Sallie W. Gladney and Teresa J. Womack.

Bruce R. Ellisen, Attorney, Appellate Section, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With him on the brief were John A. DiCicco, Acting Assistant Attorney General, and Arthur T. Catterall, Attorney.

Appealed from: United States Court of Federal Claims

Judge Susan G. Braden

United States Court of Appeals for the Federal Circuit

2009-5010

WILLIAM H. SCHELL and RUBY G. SCHELL,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 04-CV-1743,

Judge Susan G. Braden.

DECIDED: December 22, 2009

Before LOURIE, ARCHER, and GAJARSA, Circuit Judges.

GAJARSA, Circuit Judge.

William H. Schell and Ruby G. Schell (collectively "Taxpayers") appeal from the decision of the Court of Federal Claims ("trial court") dismissing their complaint that alleged the Internal Revenue Service ("IRS") unlawfully denied their claim for a tax refund for the tax years 1993 and 1995. See Schell v. United States, 84 Fed. Cl. 159 (2008). Because we find that Taxpayers do

not have standing to challenge the actions of the IRS, we affirm the trial court's finding that it lacked jurisdiction over the Taxpayers' refund claims.

BACKGROUND

In the early 1980s, American Agri-Corp, Inc. ("AMCOR") organized a number of limited partnerships and solicited investments from individuals. In the mid-1980s, William H. Schell invested in two limited partnerships offered by AMCOR. Specifically, Mr. Schell held a limited partnership interest in Canyon Desert Vineyards ("CDV") during the tax years 1985-1993 and in Vista Ag-Realty Partners ("VARP") during the tax years 1986-1995. In 1985, CDV reported losses on farming expenses of approximately $7.4 million and $196,000 as "other deductions." Mr. Schell reported his pro rata share of his loss, which totaled $73,811, on his 1985 tax return. In 1986, VARP reported losses on farming expenses of approximately $11.1 million and $291,000 as "other deductions." Mr. Schell reported his pro rata share of his loss, which totaled $69,840, on his 1986 tax return.

After examining the returns of these partnerships, the IRS issued a Notice of Final Partnership Administrative Adjustment ("FPAA") to each partnership, disallowing farming expenses and other deductions. The listed reasons for complete disallowance included the IRS' findings that "[t]he partnership's activities constitute a

series of sham transactions" and "[t]he partnership's activities lack economic substance." Both CDV and VARP filed petitions for readjustment of these findings in the United States Tax Court. CDV and VARP dissolved in 1993 and 1995, respectively.

In April 1997, while CDV and VARP's petitions for readjustment were pending before the Tax Court, the Taxpayers entered into two settlement agreements with the IRS. Under these partner-specific settlement agreements, the $7.6 million net loss reported by CDV in 1985 was reduced by fifty five percent, or approximately $3.4 million. The $11.1 million net loss reported by VARP in 1986 was reduced by fifty percent, or approximately $5.6 million. The settlement agreements made no mention of the "sham transaction" determinations in the FPAAs.

In 1998, the Taxpayers filed an "AMCOR-Related Refund Claim" for the tax year 1995, decreasing their 1995 income from VARP by $9,522. As a result, the IRS refunded $3,930 plus interest. In 1999, the Taxpayers filed a refund claim for the tax year 1993 and a second refund claim for the tax year 1995, claiming that "[a]s a direct consequence of the settlement and the corrections of the erroneous reporting of a termination distribution, there was a substantial basis in the partnership interest and a resulting loss upon the dissolution and termination of the

partnership, which loss is the basis of this claim for refund."

In 2001, the Tax Court issued decisions in the partnership-level proceedings. The decisions found that the adjustments to partnership income and expense were attributable to transactions "which lacked economic substance . . . so as to result in a substantial distortion of [partnership income and/or expense]."

In 2002, the IRS rejected the Taxpayers' second refund claim for the tax year 1995. The IRS also informed the Taxpayers that AMCOR claims are treated as capital losses and it included instructions for claiming these losses. The IRS has not taken any action on the 1993 refund claim.

Instead of resubmitting their claim, the Taxpayers filed a complaint in the trial court, alleging that the IRS unlawfully denied the Taxpayers' claim for a tax refund for the tax years 1993 and 1995. The Taxpayers' theory was that the 1997 settlement agreements increased their basis of the partnership interest by the amount of loss the settlement agreements disallowed. The government filed a motion to dismiss, arguing that the trial court lacked subject matter jurisdiction under I.R.C. §7422(h), or in the alternative, that the Taxpayers failed to state a claim under Court of Federal Claims Rule 12(b)(6). The court granted the government's motion holding that: (1) the losses identified in the Taxpayers' 1999 tax refund claims concern "partnership items," which the

Taxpayers have no standing to pursue under §7422(h); and (2) the exception to §7422(h) under I.R.C. §6230(c)(1)(B) does not apply because the 1997 settlement agreements did not alter the FPAA's findings that the activities of CDV and VAPR were sham transactions and thus did not convert the partnership items into non-partnership items.

The Taxpayers timely appealed to this court. We have jurisdiction to review the final decision of the trial court pursuant to 28 U.S.C. §1295(a)(3).

DISCUSSION

The Court of Federal Claims' decision to grant the government's motion to dismiss for lack of jurisdiction is a matter of law that we review de novo. Mudge v. United States, 308 F.3d 1220, 1224 (Fed. Cir. 2002). As the party seeking the exercise of jurisdiction, the Taxpayers have the burden of establishing that jurisdiction exists. Rocovich v. United States, 933 F.2d 991, 993 (Fed. Cir. 1991).

I.

A partnership is not a taxable entity. Partnerships neither incur tax liability, nor do they pay taxes. Before Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), each partner filed his own tax return reflecting his distributive share of the partnership's gains and losses, and IRS audited each individual partner in the partnership. As a consequence, the IRS could not guarantee

consistent treatment of a partnership item for each partner in a partnership. To address this concern, TEFRA was enacted and the treatment of partnership items is now resolved in a unified partnership-level proceeding. See I.R.C. §6221 (2006). Partnerships are required to file informational returns reflecting the distributive shares of income, gains, deductions, and credits attributable to their partners, while individual partners are responsible for reporting their pro rata share of tax on their income tax returns. See I.R.C. §701.

TEFRA defines three types of items: "partnership item," "nonpartnership item," and "affected item." "Partnership item" generally encompasses items "required to be taken into account for the partnership's taxable year," and those "more appropriately determined at the partnership level than at the partner level." I.R.C. §6231(a)(3). Such items include the income, gains, losses, deductions, and credits of a partnership. Treas. Reg. §301.6231(a)(3)-1(a) (2009). The term also includes "the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing and characterization of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b). "Nonpartnership items" are those items that are not partnership items, and an "affected item" is defined as "any item to the extent such item is affected by a partnership item." I.R.C. §6231(a)(4)-(5). An example of an "affected item" is

a partner's tax basis in his partnership interest, which is affected by partnership items such as partnership income or loss.

If the IRS decides to adjust any "partnership items" reflected on the partnership's return, it must notify the individual partners of the adjustment through a FPAA. See I.R.C. §6223. For ninety days after a FPAA issues, the tax matters partner has the exclusive right to challenge the proposed adjustments in United States Tax Court, the Court of Federal Claims, or a United States District Court. I.R.C. §6226(a).

At the partner level, a partner may contest the tax liability by paying the assessment and filing a refund action in the Court of Federal Claims. I.R.C. §6226(e). However, TEFRA limits a partner's ability to seek a refund based on adjustments made to the partnership's return by depriving all courts of jurisdiction to hear partner refund claims where the refund is "attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)." I.R.C. §7422(h).

Alternatively, a partner may choose to settle his individual tax liability with the IRS. I.R.C. §6224. When a partner chooses to settle his individual tax liability with the IRS, that partner would no longer participate in the partnership level proceeding, and instead would be bound by the terms of his settlement agreement. See I.R.C. §6224. If the IRS enters into a settlement agreement with any

partner with respect to partnership items, other partners are entitled to a consistent settlement as to those partnership items. I.R.C. §6224(c)(2).

II.

The Taxpayers argue that their 1999 refund claims are not barred by §7422(h) because they are not attributable to partnership items; and even if they are, the §6230(c)(1)(B) exception to the §7422(h) jurisdictional bar should apply.

Specifically, the Taxpayers argue that their refund claims are not barred by §7422(h) because they are attributable to the loss of Schell's tax basis in his partnership interests upon termination of the partnerships. The government does not dispute that the Taxpayers' basis in their partnership interest is not a partnership item. Instead, the government argues that the Taxpayers' refund claims are "attributable to partnership items." See I.R.C. §7422(h) (emphasis added). This court has held that the applicability of §7422(h) turns on whether the Taxpayers' refund claims are "due to, caused by, or generated by" a partnership item. Keener v. United States, 551 F.3d 1358, 1365 (Fed. Cir. 2009) (quoting Electrolux Holdings, Inc. v. United States, 491 F.3d 1327, 1331 (Fed. Cir. 2007).

It is widely accepted that a transaction that lacks economic substance is not recognized for federal income tax purposes. See id. at 1365; see also Coltec Indus., Inc. v. United States, 454 F.3d

1340, 1353-54 (Fed. Cir. 2006); Lerman v. Comm'r, 939 F.2d 44, 45 (3d Cir. 1991) (stating that a transaction that "is devoid of economic substance . . . simply is not recognized for federal taxation purposes"); Kirchman v. Comm'r, 862 F.2d 1486, 1490 (11th Cir. 1989); Salley v. Comm'r, 464 F.2d 479, 483 (5th Cir. 1972); Winn-Dixie Stores, Inc. v. Comm'r, 113 T.C. 254, 278 (1999) (stating that "denial of recognition means that such a transaction cannot be the basis for a deductible expense"). Thus, a sham transaction, devoid of economic substance, cannot be the basis for a deductible loss. Therefore, the Taxpayers' refund claims are based on the assertion that the partnerships' transactions were not shams. This court has previously held that the question of whether a partnership transaction is a "sham" is a "partnership item." Keener, 551 F.3d at 1365-66. Accordingly, the Taxpayers' claims are "attributable to" partnership items and the trial court correctly determined that it lacked jurisdiction over the Taxpayers' refund claims.

The Taxpayers also argue that the §6230(c)(1)(B) exception to the §7422(h) jurisdictional bar should apply. Section 6230(c)(1)(B) provides an exception to §7422(h):

> A partner may file a claim for refund on the grounds that . . . the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a

> settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).

When a partner chooses to settle his individual tax liability with the IRS, the settling individual's partnership items are converted to non-partnership items, but only when the IRS enters into a settlement agreement with the partner with respect to such items. See I.R.C. §6231(b)(1)(C) ("[T]he partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date . . . the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner with respect to such items . . . .") (emphasis added). Thus, when a partner files an action for a refund attributable to partnership items that have been converted through a settlement agreement, the jurisdictional bar of §7422(h) no longer applies. See id.

The Taxpayers argue that, even if their claims are attributable to partnership items, the IRS "failed to allow credit or make a refund . . . attributable to the application to the partner" of the 1997 settlement agreements. They argue that the 1997 settlement agreements effectively determined that the partnerships' transactions were not shams, and the sham-transaction issue was converted to non-partnership item under §6231(b)(1)(C).

It is undisputed that the 1997 settlement agreements did not explicitly address the sham-transaction issue. The Taxpayers argue, however, that the IRS implicitly conceded that the partnerships' transactions were not shams because: (1) §6224(c) settlements are comprehensive; and (2) the IRS allowed partial deductions, whereas no deduction is allowed for sham transactions. Both of these arguments are without merit. The Taxpayers' argument that all §6224(c) settlements are comprehensive stems from a regulation that reads, "[s]ettlements shall be comprehensive, that is, a settlement may not be limited to elected items." Temporary Regulations, 52 Fed. Reg. 6779, 6787 (Mar. 5, 1987) (issuing Temporary Regulation §301.6224(c)-3T(b)). As the government correctly notes, however, the cited regulation does not require that every §6224(c) settlement be "comprehensive"; rather, it requires that, to obtain a consistent settlement, a partner who enters into a settlement agreement must agree to all the terms that were in the settlement agreement that the IRS previously entered into with other partners. See Keener v. United States, 76 Fed. Cl. 455, 465 (2007), aff'd, 551 F.3d 1358 (Fed. Cir. 2009). In addition, the Taxpayers' argument that the IRS implicitly conceded that the partnerships' transactions were not shams by allowing partial deductions is wholly without merit. The fact that the IRS chose to settle does not follow that it conceded that the transactions were not shams. In addition, that the FPAAs listed

"sham transaction" as one of several grounds for disallowing partnership does not, as the Taxpayers suggest, render the FPAAs less conclusive. Keener, 551 F.3d at 1366.

CONCLUSION

Because the 1997 settlement agreement did not change the FPAA's findings that the activities of CDV and VARP were sham transactions, the sham-transaction issue was not converted into a non-partnership item, and the Taxpayers' refund claims necessarily involve resolution of "partnership items." Accordingly, the Taxpayers do not have standing to seek adjudication, and the trial court correctly determined that it lacked jurisdiction over the Taxpayers' refund claims.

AFFIRMED

COSTS

Costs to the Appellee.

In The United States
Court of Federal Claims

Nos. 04-1743T

Filed: September 30, 2008
TO BE PUBLISHED

	*	Jurisdiction;
WILLIAM H. SCHELL	*	Standing;
and RUBY G. SCHELL,	*	Substantial Variance
	*	Doctrine;
Plaintiffs,	*	Tax Equity and Fiscal
	*	Responsibility Act of
v.	*	1982, 26 U.S.C.
	*	§§6221–33;
THE UNITED STATES,	*	Tucker Act, 28 U.S.C.
	*	§1491;
Defendant.	*	26 U.S.C. §§7422(a), (h);
	*	RCFC 12(b)(1).

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Karen E. Servidea, United States Department of Justice, Tax Division, Washington, D.C., Councel for Defendant.

MEMORANDUM OPINION AND FINAL ORDER

BRADEN, *Judge*.

I. FACTUAL BACKGROUND.[1]

In the mid-1980s, William H. Schell invested in two limited partnerships offered by American Agri-Corp ("AMCOR")[2]. William H. Schell held a limited partnership interest in Canyon Desert Vineyards ("CDV") during the tax years 1985–93 and in Vista Ag-Realty ("VAR") during the tax

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[1] The facts recited herein were derived from: the December 6, 2004 Complaint ("Compl."); Plaintiffs' Exhibits In Support Of The Complaint ("Pls. Ex."); the Government's December 20, 2007 Motion To Dismiss The Complaint And Brief In Support ("Gov't Br."); the Government's December 20, 2007 Exhibits In Support ("Gov't Ex."); Plaintiffs' April 2, 2008 Response ("Pls. Resp."); and the Government's May 12, 2008 Reply ("Gov't Reply").

[2] In *Prati v. United States*, 81 Fed. Cl. 422 (2008), the United States Court of Federal Claims, described the nature of AMCOR partnerships, as follows:

> In the early 1980s, AMCOR organized a number of limited partnerships for which it acted as the corporate general partner. The AMCOR Partnerships were agricultural investment entities geared towards high income professionals, and AMCOR solicited investments from such individuals across the country. AMCOR's stated goal was to develop farmland, grow fruit crops such as dates, and other crops such as wheat, corn and alfalfa. By 1987, the AMCOR Partnerships had become the subject of an IRS audit and investigation. The IRS alleged that the AMCOR Partnerships . . . were actually illegal tax shelters.

Id. at 425-26 (internal citation omitted).

years 1986–95. See Compl. ¶¶ 6, 13. For fiscal year 1985, CDV reported losses on farming expenses of approximately $7.4 million and $196,000 in miscellaneous expenses. *See* Gov't Ex. 1, App. B at B-5. William H. Schell and his wife, Ruby G. Schell[3] ("Plaintiffs"), reported these losses on their joint 1985 federal tax return and claimed a deduction of $73,811, their share of this partnership loss. See Gov't Ex. 2, App. B at B-24; see also Gov't Ex. 3, App. B at B-38 (Pls. 1985 Schedule K-1 for CDV). In addition, CDV reported approximately $6.4 million of partnership liabilities in 1985, of which $62,525 was attributed to and reported by Plaintiffs as a loss. *See* Gov't Ex. 1, App. B at B-6; Gov't Ex. 3, App. B at B-38; Gov't Ex. 4, App. B at B-41.

In fiscal year 1986, VAR also reported substantial losses. *See* Gov't Ex. 9, App. B at B-82 (VAR federal income tax partnership return for fiscal year 1986). VAR reported a net loss of approximately $11.1 million on farming expenses and approximately $291,000 of miscellaneous expense deductions. *See* Gov't Br. at 8; Gov't Ex. 9, App. B at B-82. Plaintiffs' share of the VAR partnership loss totaled $69,840. *See* Gov't Br. at 9; Gov't Ex. 11, App. B at B-115. Like CDV, VAR also reported approximately $10.9 million of partnership liabilities for 1986, of which $35,000

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[3] Ruby G. Schell is a party, because she and her husband filed joint federal income tax returns. *See* Compl. ¶ 5.

was Plaintiffs' share. *See* Gov't Ex. 9, App. B at B-83; Gov't Ex. 11, App. B at B-115. Plaintiffs reported on their 1986 federal tax returns that CDV and VAR had losses. *See* Gov't Ex. 10, App. B at B-92, 99, 112 (Pls. 1986 Federal Tax Return); *see also* Gov't Ex. 11, App. B at B-115 (Pls. 1986 Schedule K-1 for VAR).

On March 14, 1990 and April 10, 1991, the Internal Revenue Service ("IRS") sent CDV and VAR a Final Partnership Administrative Adjustments ("FPAA"),[4] disallowing all claimed deductions. *See* Gov't Ex. 5, App. B at B-57-62. Both CDV and VAR contested these IRS rulings in the United States Tax Court. *See* Gov't Ex. 5, App. B at B-44 (CDV's Petition For Readjustment); *see also* Gov't Ex. 13, App. B at B-122 (VAR's Petition

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[4] Section 6223(a) of the Internal Revenue Code ("I.R.C.") provides that:

> (a) [the] Secretary [of the Treasury Department ("the Secretary")] must give partners notice of beginning and completion of administrative proceedings. The Secretary shall mail to each partner whose name and address is furnished to the Secretary notice of--
>
> (1) the beginning of an administrative proceeding at the partnership level with respect to a partnership item, and
>
> (2) the *final partnership administrative adjustment* resulting from any such proceeding.

26 U.S.C. §6223(a) (emphasis added).

For Readjustment). Sometime in 1993, CDV was dissolved. *See* Compl. ¶ 7. In 1995, VAR was dissolved. See Compl. ¶ 14.

On April 28, 1997, while CDV's and VAR's Petitions For Readjustment were pending before the United States Tax Court, Plaintiffs entered into two Settlement Agreements with the IRS that disallowed approximately half of the partnership deductions reported.[5] See Gov't Ex. 6, App. B at B-66 (Settlement Agreement with CDV); Gov't Ex. 14, App. B at B-136 (Settlement Agreement with VAR).

On March 29, 1999, Plaintiffs filed a claim for a refund of $6,797, representing their proportionate share of interest in the dissolved VAR. *See* Pls. Ex. 2. On April 23, 1999, Plaintiffs also filed a claim with the IRS for a tax refund of $12,862, representing their interest in the now dissolved CDV. *See* Pls. Ex. 1. Plaintiffs claimed the termination of the two partnerships entitled them to deduct the losses against Schell's partnership interests. *See* Compl. ¶¶ 9(D), 17(D) ("As a direct consequence of the settlement and the corrections of the erroneous reporting of a termination

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[5] The April 28, 1997 Settlement Agreements disallowed "approximately $3.4 million, or approximately 45%, of the farming and miscellaneous deductions [that] CDV originally reported" and "approximately $5.6 million, or approximately 50%, of the farming and miscellaneous deductions [that] VAR originally reported." Gov't Br. at 7, 10; *see also* Gov't Ex. 6, App. B at B- 66.

distribution, there was a substantial basis in the partnership interest and a resulting loss upon the dissolution and termination of the partnership, which loss is the basis of this claim for refund."). In calculating the amount of their tax refund claims, Plaintiffs asserted that the Settlement Agreements increased the basis of Schell's partnership interest by the amount of disallowed loss, and Plaintiffs offset this amount by any income or distribution received. *Id.* at 12-13.

On December 6, 2002, the IRS rejected Plaintiffs' March 29, 1999 VAR tax refund claim, but informed Plaintiffs that the "AMCOR claims" would be treated as capital losses and included instructions for claiming those losses. *See* Pls. Ex. 3. To date, the IRS has taken no action on Plaintiffs' April 23, 1999 CDV refund claim. *See* Compl. ¶¶ 9, 10.[6]

II. PROCEDURAL HISTORY.

On December 6, 2004, a Complaint was filed in the United States Court of Federal Claims alleging that the IRS unlawfully denied Plaintiffs' claims for a tax refund for the 1993 and 1995 tax years. *See* Compl. The case was assigned to the undersigned judge. On February 4, 2005, the parties filed a Joint Motion To Stay pending the

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[6] In 2001, however, the United States Tax Court disallowed similar deductions claimed in *Canyon Desert Vineyards v. Comm'r of Internal Revenue*, No. 15054-91 (T.C. July 19, 2001).

final resolution of: *Isler v. United States*, Fed. Cl. No. 01-344T; *Scuteri v. United States*, Fed. Cl. No. 01-358T; and *Prati v. United States*, Fed. Cl. No. 02- 060T.

On April 19, 2006, Chief Judge Edward J. Damich caused this case and other AMCOR tax refund cases to be transferred to the Honorable Lawrence J. Block for "administrative convenience." Apparently, Chief Judge Damich was under the misimpression that the legal issues presented in this case were the same as *Prati*, the lead case before Judge Block. On May 9, 2006, Judge Block reassigned this case back to the undersigned judge, since the legal issues to be adjudicated in *Prati* were: 1) whether IRS's assessment complied with the statute of limitations (*see Prati*, 81 Fed. Cl. at 429-37); 2) whether the United States Court of Federal Claims had jurisdiction to adjudicate Plaintiffs' claim for interest assessed under 26 U.S.C. §6621(c) (*id.* at 437-39); and 3) whether the IRS abused its discretion in refusing to abate the penalty assessed against Plaintiffs. *Id.* at 439-40. None of these legal issues were presented in this case.

On January 4, 2007, the parties requested that the court continue to stay this case, because of the consideration of the United States Supreme Court in another pending federal tax case. Based on that representation, the court granted the stay on January 5, 2007. On May 21, 2007, the United States Supreme Court issued an opinion in *Hinck*

v. United States, 127 S. Ct. 2011 (2007), holding that the United States Tax Court is the exclusive forum for judicial review of a failure to abate interest. On September 5, 2007, the court convened a telephone conference to confirm that *Hinck*, in fact, was not dispositive of any claims in this case. On September 17, 2007, the court issued an Order To Lift The January 5, 2007 Stay and required the Government to file an Answer or dispositive motion by November 5, 2007.

After receiving a 45-day extension of time, the Government filed a Motion To Dismiss on December 20, 2007. On March 18, 2008, the court ordered Plaintiffs to respond on or before April 1, 2008. Plaintiffs filed a Response on April 2, 2008, by leave of the court. On May 12, 2008, the Government filed a Reply.

III. DISCUSSION.

A. Jurisdiction.

The jurisdiction of the United States Court of Federal Claims is established by the Tucker Act. *See* 28 U.S.C. §1491. This Act authorizes the court "to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." *Id.* §1491(a)(1). The Tucker Act, however, is "a jurisdictional statute; it does

not create any substantive right enforceable against the United States for money damages. . . . [T]he Act merely confers jurisdiction upon it whenever the substantive right exists." *United States v. Testan*, 424 U.S. 392, 398 (1976).

Therefore, in order to pursue a substantive right within the jurisdictional reach of the Tucker Act, a plaintiff must identify and plead an independent contractual relationship, constitutional provision, federal statute, or executive agency regulation that provides a substantive right to money damages. *See Todd v. United States*, 386 F.3d 1091, 1094 (Fed. Cir. 2004) ("[J]urisdiction under the Tucker Act requires the litigant to identify a substantive right for money damages against the United States separate from the Tucker Act itself."); *see also Fisher v. United States*, 402 F.3d 1167, 1172 (Fed. Cir. 2005) ("The Tucker Act itself does not create a substantive cause of action; in order to come within the jurisdictional reach and the waiver of the Tucker Act, a plaintiff must identify a separate source of substantive law that creates the right to money damages.").

The United States Court of Appeals for the Federal Circuit has affirmed that the United States Court of Federal Claims has jurisdiction over federal tax refund claims, pursuant to 26 U.S.C. §7422(a). Thereunder, no claim for a tax refund may be filed unless such a claim first has been filed with the IRS. *Id.* ("*No* suit or proceeding

shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected . . . until a claim for refund or credit has been duly filed with the Secretary[.]"). The burden of establishing jurisdiction falls upon the party asserting jurisdiction. *See FW/PBS, Inc. v. Dallas*, 493 U.S. 215, 231 (1990) (holding that the burden is on the party seeking the court to exercise jurisdiction to allege facts sufficient to establish jurisdiction); *see also* RCFC 12(b)(1). In addition, the tax amount in dispute must be paid before a refund suit may be initiated in the United States Court of Federal Claims. *See* 26 U.S.C. §1346(a); *see also Flora v. United States*, 362 U.S. 145, 146 (1960).

B. Standing.

The United States Supreme Court has stated that "the question of standing is whether the litigant is entitled to have the court decide the merits of the dispute or of particular issues." *Warth v. Seldin*, 422 U.S. 490, 498 (1975). Standing must be determined "as of the commencement of suit." *Rothe Dev. Corp. v. Dep't of Def.*, 413 F.3d 1327, 1334 (Fed. Cir. 2005). The party invoking federal jurisdiction bears the burden of establishing standing. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992). Specifically, to establish standing, "a plaintiff must show [that] it has suffered an 'injury in fact' that is . . . concrete and particularized and . . . actual or imminent, not

conjectural or hypothetical; . . . the injury is fairly traceable to the challenged action of the defendant; and . . . it is likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision." *Friends of the Earth, Inc. v. Laidlaw Envtl. Serv., Inc.*, 528 U.S. 167, 180-81 (2000) (citing *Lujan*, 504 U.S. at 560-61).

C. Standard For Decision On A Motion To Dismiss, Pursuant To RCFC 12(b)(1).

A challenge to the United States Court of Federal Claims' "general power to adjudicate in specific areas of substantive law . . . is properly raised by a [Rule] 12(b)(1) motion[.]" *See Palmer v. United States*, 168 F.3d 1310, 1313 (Fed. Cir. 1999); see also RCFC 12(b)(1) ("Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter[.]"). When considering whether to dismiss an action for lack of subject matter jurisdiction, the court is "obligated to assume all factual allegations to be true and to draw all reasonable inferences in plaintiff's favor." *Henke v. United States*, 60 F.3d 795, 797 (Fed. Cir. 1995). Plaintiff bears the burden of establishing jurisdiction by a preponderance of the evidence. *See Reynolds v. Army & Air Force Exch. Serv.*, 846 F.2d 746, 748 (Fed. Cir. 1988) ("[O]nce the [trial] court's subject

matter jurisdiction [is] put in question, . . . [the plaintiff] bears the burden of establishing subject matter jurisdiction by a preponderance of evidence.").

D. The Tax Equity And Fiscal Responsibility Act of 1982.

Prior to 1982, partnerships were treated as aggregate entities. *See* MICHAEL D. ROSE & JOHN C. CHOMMIE, FEDERAL INCOME TAX §9.02 (3d ed. 1988). Federal tax returns were filed by each partner, and the IRS was required to resolve any problems with each partner separately. Id. To correct administrative problems inherent in this scheme, Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). See Pub. L. 97-248 (codified in 26 U.S.C. §§6221–33); *see also ROSE, supra*, §9.02. Under TEFRA, "partnership items" are to be determined in partnership level proceedings. *See* 26 U.S.C. §6221; *see also* 26 U.S.C. §6231(a)(3) (defining a "partnership item" as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A"); 1 WILLIAM S. MCKEE ET AL., FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS ¶10.01 (4th ed. 2008). Partnership level proceedings may only be initiated by a "tax matters partner." *See* 26 U.S.C. §6226(a);[7] *see also* 26 U.S.C. §6231(a)(7).[8]

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[7] Section 6226(a) of the Internal Revenue Code ("I.R.C.") provides:

Petition by tax matters partner.--Within 90 days after the day on which a notice of a final partnership administrative adjustment is mailed to the tax matters partner, the tax matters partner may file a petition for a readjustment of the partnership items for such taxable year with--

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the [United States] Court of Federal Claims.

26 U.S.C. §6226(a).

[8] Section 6231(a)(7) defines a "tax matters partner" as:

(7) Tax matters partner.--The tax matters partner of any partnership is--

(A) the general partner designated as the tax matters partner as provided in regulations, or

(B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership at the close of the taxable year involved (or, where there is more than 1 such partner, the 1 of such partners whose name would appear first in an alphabetical listing).

If there is no general partner designated under subparagraph (A) and the Secretary determines that it is impracticable to apply subparagraph (B), the partner selected by the Secretary shall be treated as the tax matters partner. The Secretary shall, within 30 days of selecting a tax matters partner under the preceding sentence, notify all partners required to

E. The Government's Motion To Dismiss, Pursuant to RCFC 12(b)(1).

1. The Parties' Arguments.

a. The Government's Argument.

A taxpayer claiming a loss deduction must demonstrate the "objective legitimacy" of the transaction in which the taxpayer invested. See Gov't Br. at 16 (citing *Brown v. United States*, 396 F.2d 459, 460-61 (Ct. Cl. 1968) (considering objective nature of underlying transaction before denying claimed loss)). Therefore, Plaintiffs' claimed losses in the CDV and VAR partnerships first require adjudication as to whether "the partnerships' managing partners acted with a profit motive and whether the partnerships' transactions were not shams." *Id.* at 18. Under TEFRA, however, the objective legitimacy of partnership transactions is a "partnership item," and "the tax treatment of any partnership item . . . shall be determined at the partnership level." *Id.* at 19-20 (citing 26 U.S.C. §6221;[9] *see also* Treas.

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receive notice under section 6223(a) of the name and address of the person selected.

26 U.S.C. §6231(a)(7).

[9] Section 6221 of the I.R.C. states:

Except as otherwise provided in this subchapter, the tax treatment of any partnership item (and the

Reg. §301.6231 (defining a "partnership item" to involve "legal and factual determinations that underline the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction[.]")). Since Plaintiffs are not "tax matter partners," the Government, in effect, argues they do not have standing to request adjudication of "partnership-items" in the United States Court of Federal Claims. *Id.* at 21 (citing 26 U.S.C. §7422(h) ("No [individual taxpayer] action may be brought for refund attributable to partnership items.")); *see also Keener v. United States*, 76 Fed. Cl. 455, 468- 470 (2007) (acknowledging that "[c]ourts directly dealing with the sham transaction doctrine have concluded that its application presents a partnership item.").

In addition, the Government argues that no "jurisdictional exception" applies. *See* Gov't Br. at 21. Section 7422(h) of the I.R.C. provides that "[n]o [individual taxpayer] action may be brought for refund attributable to partnership items," unless one of two exceptions applies. *Id.* (citing 26 U.S.C. §7422(h)). The December 6, 2004 Complaint invokes one of these exceptions, Section 6230(c)(1)(B) of the I.R.C., that provides:

> applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item) *shall be determined at the partnership level.*

26 U.S.C. §6221 (emphasis added).

> A partner may file a claim for refund on the grounds that . . . the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).

26 U.S.C. §6230(c)(1)(B). The December 6, 2004 Complaint asserts that "the Secretary has failed to make a refund [to Plaintiffs] for the overpayment attributable to" the application of the settlement agreements that were entered for tax years 1985 and 1986. *See* Compl. ¶¶ 9(E), 17(E).

The Government explains that a court, adjudicating a partner-level suit, may only "incorporate the partnership-level determination of partnership items into the partner-level suit," and therefore "lack[s] jurisdiction to determine such items for itself." Gov't Br. at 22 (citing 26 U.S.C. §6230(c)(4) ("For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the [S]ettlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive.")); *see also* Gov't Ex. 6, 14, App. B (the April 18, 1997 Settlements provide that: "no claim for refund or credit based on any change in the treatment of partnership items may be filed or

prosecuted"). Therefore, Plaintiffs may invoke the Section 6230(c)(1)(B) exception, but only after a "determination that the partnership[s'] transactions were entered into for profit and were not shams." Gov't Br. at 23. The final partnership records for the CDV and VAR partnerships, however, contain no such determination, nor does the April 18, 1997 Settlements. *Id.*

b. Plaintiffs' Response.

Plaintiffs respond that the Government misconstrues their theory of liability. See Pls. Resp. at 17 ("The government's representation of how the [Plaintiffs'] basis was computed is patently wrong and fails to reflect the income reported . . . in the years after 1986[.]"). Plaintiffs' 1993 and 1995 "loss deductions are not substantially the same partnership loss deduction they claimed in 1985 and 1986 . . . The 1993 and 1995 losses represent the Schells' outside basis in the investment in the partnerships as of the time the partnerships were terminated[.]" *Id.* at 13. Even beginning "with [a] zero basis at the end of 1985 and 1986, [Plaintiffs'] basis in 1993 and 1995 was as claimed on their refund claim." *Id.* at 17. In support, Plaintiffs cite two IRS communications. *Id.* at 13, 17 (citing "AMCOR CLAIM INSTRUCTIONS" and a January 6, 2000 Regional Counsel Memorandum).[10] In addition, Plaintiffs

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[10] "AMCOR CLAIM INSTRUCTIONS" states, in part, that: "A claim may be filed to reflect the increase in your

also assert that the IRS incorrectly classified those losses as capital losses, because they "did not result from sale but termination[.]" *Id.* at 14.

Finally, Plaintiffs contend that the April 28, 1997 Settlements were "comprehensive and conclusive" and all of the relevant items were transformed therein into "nonpartnership items." *See* Pls. Resp. at 10-11 (citing 26 U.S.C. §6231(b)(1)(C) ("The partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner with respect to such items[.]")). Plaintiffs argue that "if a partner settles his partnership items, subsequent determinations at the partnership level will not apply to the settling partner, and §7422(h)'s jurisdictional bar no longer applies," thereby allowing Plaintiffs to litigate their claims before this court. *Id.* at 14.

c. The Government's Reply.

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basis due to the sale of the partnership interest." Pls. Resp. at 13. The January 6, 2000 Regional Counsel Memorandum provides that: "The individual investor's transcript of account for this taxable year should show an assessment of tax being made as a result of a computational adjustment relating to Form 870-P(AD). *Id.* at 17. The partner's basis will be increased, under the provisions of I.R.C. 705, by the amount his taxable income was increased as a result of the settlement." *Id.*

The Government replies that the April 10, 1991 FPAA conclusively determined that all of the partnership transactions that gave rise to the CDV and VAR losses were "shams." *See* Gov't Reply at 9–14. The April 28, 1997 Settlement Agreements did not re-visit this issue and therefore did not change the FPAA's determination. *Id.* at 12 ("The settlement agreements at issue here . . . contain no determination that CDV's or VAR's transactions were *bona fide* or entered into for profit."). Accordingly, the FPAA "sham transaction" determination cannot be re-litigated here. *Id.* at 13.

Plaintiffs could "have decided to settle the amount of partnership losses" and still contest the sham-transaction determination. *Id.* at 12-13. That did not happen. Id. Section 6231(b)(1)(C) converts "partnership items" into "non-partnership items," but only where those items *specifically* are settled by agreement. *Id.* at 13 (citing 26 U.S.C. §6231(b)(1)(C) ("The partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner *with respect to such items*[.]" (emphasis added))). In this case, the April 28, 1997 Settlement Agreements that Plaintiffs accepted did not address the sham-transactions at issue, nor was this issue specifically reserved therein for further adjudication. *Id.* (citing *Keener*, 76 Fed. Cl. at 463-464 ("[W]hile [the plaintiffs] contend that the

[settlement] agreements were sufficient to convert the limitations issue into a nonpartnership item [pursuant to 26 U.S.C. §6231(b)(1)(C)], they assert that the agreements did not resolve the limitations issue, leaving them free to litigate that issue here. If plaintiffs are right, their agreements put them in a truly enviable position-what might be described as 'heads we win, tails we win bigger[.]'")). Accordingly, Plaintiffs agreed to forgo adjudication of the sham transaction issue.

2. The Court's Resolution.

Plaintiffs' refund claims cover their *total* partnership losses in 1993 and 1995, during which the partnerships were dissolved and terminated. *See* Compl. ¶¶ 9(D), 17(D). Therefore, the resulting losses were dependant upon the resolution of each of the partnerships' tax claims. Plaintiffs assert that the April 28, 1997 Settlement Agreements increased the basis of Plaintiffs' partnership interest by the amount of the loss the Settlement Agreements disallowed. *Id.*; *see also* Gov't Ex. 6, App. B at B-66, Gov't Ex. 14, App. B at B-136 (April 28, 1997 Settlement Agreements with CDV and VAR) (disallowing "approximately $3.4 million, or approximately 45%, of the farming and miscellaneous deductions [that] CDV originally reported" and "approximately $5.6 million, or approximately 50%, of the farming and miscellaneous deductions [that] VAR originally reported."). Accordingly, the refund claims alleged in the December 6, 2004 Complaint are the same

losses disallowed by the April 28, 1997 Settlements. *See* Compl. ¶¶ 9(D), 17(D) (loss disallowed by April 28, 1997 Settlements affecting over 99% of April 23, 1999 CDV refund claim and 100% of March 29, 1999 VAR refund claim).

It is well established that a federal taxpayer claiming a loss deduction must demonstrate the legitimacy of the transaction at issue, necessarily requiring an inquiry into the managing partners' conduct concerning those transactions. *See Brown*, 396 F.2d at 460-61 (considering nature of underlying transaction before denying claimed loss); *see also Transpac Drilling Venture, 1983-2 by Dobbins v. United States*, 32 Fed.Cl. 810, 820 (1995), *aff'd*, 83 F.3d 1410 (Fed. Cir. 1996) ("In regards to a transaction executed by a partnership, the business motives and the reasonable possibility of profit are determined at the partnership level."). Section 6221 of the I.R.C., however, provides that the issue of whether partnership transactions are legitimate is a "partnership item," and "the tax treatment of any partnership item . . . shall be determined at the partnership level." 26 U.S.C. §6221.[11]

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[11] Section 6221 of the I.R.C. provides: "Except as otherwise provided in this subchapter, the tax treatment of any partnership item . . . shall be determined at the partnership level." 26 U.S.C. §6221; *see also* Treas. Reg. §301.6231 (defining a "partnership item" to involve "legal and factual determinations that underline the determination of the amount, timing, and characterization of items of income,

In March and April of 1999, Plaintiffs filed claims with the IRS for tax refunds for their partnership interests in the now dissolved CDV and VAR. *See* Compl. ¶¶ 8, 15. On December 6, 2002, however, the IRS rejected the VAR claim, but informed Plaintiffs that "AMCOR claims" would be treated as capital losses and included instructions for claiming these losses. *Id.* ¶ 16; *see also* Pls. Ex. 3. Therefore, the Complaint alleged sufficient facts regarding Plaintiffs' "injury in fact." *See Lujan*, 504 U.S. at 560. Nevertheless, the losses identified in Plaintiffs' March 29, 1999 and April 23, 1999 tax refund claims concern "partnership items," that Plaintiffs have no standing to pursue. *See* 26 U.S.C. §7422(h) ("No [individual taxpayer] action may be brought for refund attributable to partnership items."); *see also Keener*, 76 Fed. Cl. at 468-470 ("[C]ourts directly dealing with the sham transaction doctrine have concluded that its application presents a partnership item.").

Plaintiffs are correct that 26 U.S.C. §6230(c)(1)(B) provides an exception to Section 7422(h) of the I.R.C. *See* 26 U.S.C. §6230(c)(1)(B) ("A partner may file a claim for refund on the grounds that . . . the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement[.]"). But the Government also is correct that a court

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credit, gain, loss, deduction[.]").

adjudicating a partner-level suit does not have jurisdiction to adjudicate partnership items. *See* 26 U.S.C. §6230(c)(4) ("*No review of substantive issues*--For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the settlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive." (emphasis added)). In other words, the Section 6230(c)(1)(B) exception applies only after a competent authority settles the underlying partnership item, *i.e.*, determining that the partnerships' transactions were entered into for profit and were not shams. In this case, the final partnership records for CDV and VAR do not address this issue, nor do the April 28, 1997 Settlements specifically resolve this issue for adjudication. *See* Gov't Ex. 6, App. B at B-65; Gov't Ex. 14, App. B at B-135 (April 28, 1997 Settlement Agreements with CDV and VAR leaving FPAA's findings that the partnerships' activities were sham transactions undisturbed and providing that "the treatment of partnership items under [the] agreement [would] not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact," and that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted"). Under these circumstances, the court does not have jurisdiction to determine whether the IRS failed "to make a refund to [the Plaintiffs] in the amount of the

overpayment attributable to the application to the partner of a settlement[.]" 26 U.S.C. §6230(c)(1)(B); *see also* Compl. ¶¶ 9(E), 17(E).

Although Section 6231(b)(1)(C) converts partnership items into non-partnership items upon a settlement agreement, this provision applies only where partnership items specifically were settled by agreement. *See* 26 U.S.C. §6231(b)(1)(C) ("[T]he partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner *with respect to such items*[.]" (emphasis added)). As previously discussed, the April 28, 1997 Settlement Agreements did not address the sham transaction issue. *See* Gov't Ex. 6, App. B at B-65; Gov't Ex. 14, App. B at B-135 (April 28, 1997 Settlement Agreements with CDV and VAR). Accordingly, those "partnership items" *ipso facto* were not converted upon settlement to "non-partnership" items. *See* 26 U.S.C. §6231(b)(1)(C); *see also Keener*, 76 Fed. Cl. at 463-464 ("Assuming, arguendo, that the [settlement] agreements did not settle the [partnership item] *sub judice*, then it would seem to follow that they were ineffective to convert that issue into a nonpartnership item for purposes of [26 U.S.C. §] 7422(h).").[12]

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[12] In reply, Plaintiffs further argue that the refund claims "represent [Plaintiffs'] outside basis in the investment in the partnerships as of the time the partnerships were

Whether a partnership transaction is a "sham" is a "partnership item." *See* 26 U.S.C. §6231(a)(3); *see also* Treas. Reg. §301.6231 (defining a "partnership item" to involve "legal and factual determinations that underline the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction[.]"). Therefore, because resolution of Plaintiffs' refund claims necessarily involves resolution of "partnership items," Plaintiffs do not have

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terminated," and not the loss disallowed by the April 28, 1997 Settlement Agreements. See Pls. Resp. at 13. This *post-hoc* argument, however, is belied by the December 6, 2004 Complaint, wherein Plaintiffs seek a refund on partnership interests "as a direct consequence of the [S]ettlement[s]." Compl. ¶¶ 9(D), 17(D) (calculating CDV and VAR refund claims by the amount of loss disallowed by the April 28, 1997 Settlements). *See* Gov't Ex. 21, App. B at B-171, B-186. Even if Plaintiffs' newest argument was adopted, their refund claims still would be barred, because those claims concern a different factual basis than the March 29, 1999 and April 23, 1999 claims filed with the IRS, conflicting with the "substantial variance doctrine." *See* 26 U.S.C. §7422(a) (no tax refund suit is permitted prior to filing a claim for refund with the Secretary); *see also* Treas. Reg. §301.6402-2(b)(1) (a taxpayer claim "must set forth in detail each ground upon which a credit or a refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof."); *Ottawa Silica Co. v. United States,* 699 F.2d 1124, 1138 (Fed. Cir. 1983) (The preceding statute and regulation "preclude a taxpayer-plaintiff from substantially varying at trial the factual bases of its arguments from those raised in the refund claims it presented to the IRS.").

standing to seek adjudication of the claims in the December 6, 2004 Complaint. *See* 26 U.S.C. §7422(h).

IV. CONCLUSION.

For the aforementioned reasons, the Government's December 20, 2007 Motion To Dismiss is granted. The December 6, 2004 Complaint is dismissed, with prejudice.

The Clerk of the United States Court of Federal Claims is directed to enter judgment in accordance with this Memorandum Opinion And Final Order.

IT IS SO ORDERED.

s/ Susan G. Braden
SUSAN G. BRADEN

Judge

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2002

(Argued: April 11, 2003 Decided: May 2, 2003)

Docket No. 02-6163

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DAVID A. FIELD and ELLEN J. FIELD,

Plaintiffs-Appellants,

-v.- 02-6163

UNITED STATES OF AMERICA,

Defendant-Appellee.

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Before: HON. DENNIS JACOBS,
HON. CHESTER J. STRAUB,
Circuit Judges,
HON. GREGORY W. CARMAN,
Chief Judge.[13]

Appeal from a judgment, entered in the United States District Court for the Southern District of New York (Scheindlin, J.), dismissing a complaint for lack of subject matter jurisdiction.

Vacated and remanded.

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[13] Honorable Gregory W. Carman, Chief Judge of the United States Court of International Trade, sitting by designation.

ELLIOT I. MILLER, New York, NY (David A. Field, on the brief), for Plaintiffs-Appellants David A. Field and Ellen J. Field.
MICHAEL M. KRAUSS, Assistant United States Attorney for the Southern District of New York (James B. Comey, United States Attorney, and Jeffrey S. Ostericher, Assistant United States Attorney, on the brief), for Defendant-Appellee United States of America.

PER CURIAM:

The sole issue on appeal is whether the district court had jurisdiction over Plaintiffs-Appellants' tax refund action. This Court holds that jurisdiction is not foreclosed by 26 U.S.C. §7422(h) (2000) and that the district court can properly exercise jurisdiction over this matter. Therefore, the district court's decision is reversed and the case is remanded for consideration of the merits of the action.

District courts generally have subject matter jurisdiction over tax refund claims pursuant to 28 U.S.C. §1346(a)(1). However, under 26 U.S.C. §7422(h), "[n]o action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section

6228(b) or section 6230(c)."[14] Based on a plain language reading of the statute, this provision does not bar jurisdiction. The statute indicates that for jurisdiction to be foreclosed, the refund (not the item which leads to that refund) must be attributable to partnership items. In other words, the refund must be based upon the assessment of a partnership item. This reading is further supported by the inclusion of the parenthetical reference to §6231(a)(3), which defines a "partnership item." Contrary to the United States' argument, the provision does not appear to bar jurisdiction in refund actions regarding a category of items that are termed "attributable to partnership items." Thus, it is only with respect to partnership items that a refund action is precluded. "If the refund is attributable to partnership items, section 7422(h) applies and deprives the court of jurisdiction. If, on the other hand, the refund is attributable to nonpartnership items, then section 7422(h) is irrelevant, and the general grant of jurisdiction [in 28 U.S.C. §1346(a)(1)] is effective." *Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995).

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[14] Neither exception to §7422(h) is applicable to this case. Plaintiffs-Appellants do not seek a refund based upon a computational error under §6230(c), nor do Plaintiffs-Appellants seek review of the Internal Revenue Service's ("IRS") denial of a request for an administrative adjustment under §6228(b).

There are three factors which lead this Court to find that the interest assessed against Plaintiffs-Appellants under former 26 U.S.C. §6621(c) is not a partnership item. First, the statutory definition of a "partnership item" is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level." 26 U.S.C. §6231(a)(3). The IRS's regulations list items considered to be partnership items. Thus 26 C.F.R. §301.6231(a)(3)-1 states that "the following items which are required to be taken into account for the taxable year of a partnership under subtitle A of the [Internal Revenue] Code are more appropriately determined at the partnership level than at the partner level and, therefore, are partnership items," and then lists various items, which do not include interest or §6621(c) interest. 26 C.F.R. §301.6231(a)(3)-1. Additionally, former 26 U.S.C. §6621(c) was a part of subtitle F and therefore was not an item "to be taken into account . . . under subtitle A." *Id.* Thus, the statutory definition of a "partnership item" and the IRS's regulations indicate that the §6621(c) interest is not a partnership item. The refund that Plaintiffs seek is therefore not attributable to a partnership item.

Second, the United States Tax Court has previously denied jurisdiction over claims

regarding §6621(c) interest on the ground that the §6621(c) interest is not a partnership item. For example, in *Affiliated Equipment Leasing II*, the Tax Court noted its prior holding that it "lack[s] jurisdiction in a partner level proceeding to determine whether a petitioner is liable for increased interest under section 6621(c) where the only matters in dispute were additions to tax" and concluded that "section 6621(c) interest is not a 'partnership item' and is not within the [Tax] Court's scope of review in a partnership level proceeding." *Affiliated Equip. Leasing II v. Commissioner*, 97 T.C. 575, 576-78 (1991) (citing *White v. Commissioner*, 95 T.C. 209, 212 (1991)). As recently as 2000, the Tax Court determined that §6621(c) interest is an "affected item"(as defined in the margin below)[15] rather than a "partnership item" and therefore could not be reviewed at a partnership level proceeding. *Barlow v. Commissioner*, Nos. 4651-95, 4652-95, 6393-95,

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[15] An "affected item" is defined as "any item to the extent such item is affected by a partnership item." 26 U.S.C. §6231(a)(5). As the Tax Court noted in *Barlow*, there are two types of affected items. The first type "is a computational adjustment made to record the change in a partner's tax liability resulting from the proper treatment of a partnership item." *Barlow*, 2000 Tax Ct. Memo LEXIS 402, at *49 (citation omitted). The second type is an item "that is dependent on factual determinations to be made at the individual partner level." *Id.* at *50. The Tax Court found that §6621(c) interest is the latter type of affected item. *Id.* at *50-*51.

6394-95, 2000 Tax Ct. Memo LEXIS 402, at *47-*51 (T.C. Nov. 3, 2000) ("Additional interest under section 6621 is an affected item because the determination of a taxpayer's liability for such interest may require findings of fact peculiar to the particular taxpayer, namely, the amount of the taxpayer's underpayment that is attributable to a tax-motivated transaction. Because the application of section 6621(c) turns on matters that are specific to individual partners, it follows that such interest constitutes an affected item that cannot be reviewed in a partnership level proceeding.") (citations omitted). These cases reinforce the view that the penalty interest at issue in this case is not attributable to a partnership item.

Third, the parties agree that the §6621(c) interest at issue is not a "partnership item." Counsel for the United States conceded at oral argument that the item at issue is not a partnership item but rather is properly considered an affected item. Plaintiffs have consistently argued that the penalty interest is not a partnership item. The United States argues that §7422(h) should be read to bar jurisdiction over claims for refunds where the item to be refunded is "attributable to a partnership item," meaning it directly flows from a partnership item. As discussed, a plain reading of §7422(h) defeats of this argument.

For the reasons set forth above, the judgment of the district court is hereby vacated and the matter remanded for consideration on the merits.

United States Court of Appeals for the Federal Circuit

2008-5045

JADE TRADING, LLC, by and through, ROBERT W. ERVIN and LAURA KAVANAUGH ERVIN on behalf of ERVIN CAPITAL, LLC, Partners Other Than the Tax Matters Partner,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

David D. Aughtry, Chamberlain, Hrdlicka, White, Williams & Martin, of Atlanta, GA, argued for plaintiffs-appellants. With him on the brief were Nicolas F. Kory; and Linda S. Paine, of Houston, TX.

Joan I. Oppenheimer, Attorney, Appellate Section, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were Gilbert S. Rothenberg, Acting Deputy Assistant Attorney General, and Richard Farber, Attorney.

Appealed from: United States Court of Federal Claims

Judge Mary Ellen Coster Williams

United States Court of Appeals for the Federal Circuit

2008-5045

JADE TRADING, LLC, by and through, ROBERT W. ERVIN and LAURA KAVANAUGH ERVIN on behalf of ERVIN CAPITAL, LLC, Partners Other Than the Tax Matters Partner,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 03-CV-2164, Judge Mary Ellen Coster Williams

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DECIDED: March 23, 2010

Before LOURIE, ARCHER, and LINN, Circuit Judges.

ARCHER, Circuit Judge.

JadeTrading, LLC ("Jade") appeals the Court of Federal Claims' denial of its petition for readjustment of the partnership items of Jade and its affirmance of the Internal Revenue Service's ("IRS" or "Service") application of penalties at the partnership level without consideration of the

partners' reasonable cause defense. Jade Trading v. United States, 80 Fed.Cl. 11 (2007). Because the contribution of euro call options to Jade (hereinafter sometimes called the spread transaction) was a transaction that lacked economic substance, we affirm the Court of Federal Claims' denial of Jade's petition. Further, we hold that the Court of Federal Claims lacked jurisdiction to review the application of penalties based on the outside bases of Jade's partners, and we therefore vacate that portion of the court's judgment and remand for further proceedings. We also vacate as moot the Court of Federal Claims' determination that Temp. Treas. Reg. §301.6221-1T(c), (d) is not invalid.

I

A

This case is governed by certain provisions of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). See 26 §§U.S.C. 6221-31 (1998).[1] Prior to TEFRA's enactment, tax liability adjustments of individual partners based on the operations of the partnership were rendered at the partner level. "TEFRA was intended, in relevant part, to prevent inconsistent and inequitable income tax treatment between various partners of the same partnership resulting from conflicting

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[1] Hereinafter, Title 26 U.S.C. is referred to as "the Tax Code."

determinations of partnership level items in individual partner proceedings." RJT Invs. X v. Comm'r Internal Revenue, 491 F.3d 732, 737 (8th Cir.2007). Under TEFRA, all "partnership items" are determined in a single proceeding. 26 U.S.C. §6221.[2] The results of this proceeding then apply to each individual partner's income tax return. If a partner wishes to challenge any adjustment to his income tax return or to assert any partner-level defenses, he may file a partner level refund suit. 26 U.S.C. §6230(c).

B

This case involves a tax shelter designed to produce large, artificial, i.e., noneconomic, losses for tax purposes. JadeTrading, 80 Fed.Cl. at 20. In general, the tax shelter here involved four steps: "1) Investment in Foreign Currency, 2) Contribution to a Partnership, 3) Partnership Investments, 4) Termination of Partnership Interests." Id. at 24-25 (describing tax opinion prepared for potential investors by BDO Seidman, a national accounting and tax consulting firm). The investor first simultaneously purchased a European-style call option and sold a

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[2] Section 6221 of the Tax Code states "[e]xcept as otherwise provided in this subchapter, the tax treatment of any partnership item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item) shall be determined at the partnership level."

European-style call option.[3] Id. at 25. The investor next contributed the purchased and sold call options to a partnership. Id. The investor eventually exited the partnership, received an asset with a claimed high-basis and low-value, and then sold that asset in order to generate a tax loss. Id. A tax loss was anticipated because, at the time of the facts giving rise to this case, an investor's basis in a partnership was ordinarily not decreased by the amount of a contingent liability contributed to or assessed by a partnership. See Helmer v. Comm'r, 34 T.C.M. (CCH) 727 (1975) (holding that a contingent obligation, such as an option, was not a liability under §752 of the Tax Code because a partnership's obligation under the option does not become fixed until the option is exercised).[4]

C

The parties do not disagree with the basic facts found by the Court of Federal Claims. Therefore, we recite only those facts relevant to this decision.

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[3] An option is a contract that gives the buyer the right, but not the obligation, to buy or sell an asset at a predetermined price (the strike price). A European-style option is an option that can only be exercised on its expiration date.

[4] The sold call option contributed to the partnership in this case is similarly a contingent obligation that does not become fixed until it is exercised.

Robert W. Ervin and his two brothers were equal partners in a cable business, which they sold in 1999. The sale proceeds received in March 1999 resulted in a total gain to each brother of approximately $13,500,000. Because the buyer was a publicly traded company, the transaction was disclosed to the Securities Exchange Commission. Thereafter, the Ervins received numerous offers of investment and tax advice. After considering a number of these investment and tax proposals, the following transaction at issue here was entered into by the Ervin brothers.

In September 1999, the Ervin brothers each formed a single-member LLC. On September 15, 1999, each Ervin LLC entered into a separate master trading agreement with AIG, and each paid AIG an $84,100 "account opening fee" pursuant to this agreement. On September 29, 1999, each Ervin LLC purchased from AIG a call option on the euro at a strike price of 1.0840 ("purchased call option") for $15,000,020 and sold to AIG a call option on the euro at a strike price of 1.0850 ("sold call option") for $14,850,018. The options were all European-style options that expired on September 29, 2000, and had a face amount of 290,540,000 euros. Each Ervin LLC paid AIG only the difference in the premiums of the offsetting options, or $150,002.

On October 2, 1999, each Ervin LLC entered into a fifteen-month "consulting agreement" with New Vista, LLC (an affiliate of Sentinel Advisors,

LLC), which required each Ervin LLC to pay New Vista $750,000 for "consulting services." Payment of this fee was a prerequisite to the Ervin LLCs being admitted to the Jade partnership. Jade was formed by Sentinel and Banque Safra, a Luxembourg financial institution, on September 23, 1999, with Sentinel as the managing partner. On October 6, 1999, each Ervin LLC entered Jade as a partner. On that same day, each Ervin LLC contributed the above described euro call options to Jade, as well as $75,000 cash. In December 1999, each Ervin LLC withdrew from Jade. Each Ervin LLC's interest in assets distributed to it by Jade was valued at $126,122. The distributed assets consisted of Xerox stock, which was sold in 1999, and euros.

On its partnership return for 1999, Jade reported on its Schedule K (Partners' Shares of Income, Credits, Deductions, etc.) a loss of $292,015. Each of the Ervin brother's individual income tax return for 1999 claimed approximately $15 million in tax losses from his execution of the spread transaction and involvement in Jade. These tax losses resulted from each brother's increasing the basis of his interest in Jade ("outside basis") by the cost of the purchased call option ($15 million) and not decreasing this basis by the amount of the potential liability that Jade assumed under the sold call option.

After auditing the Jade partnership return, the IRS issued a final partnership administrative

adjustment ("FPAA") to Jade with respect to Jade's partnership items for the 1999 tax year. The FPAA determined that the Jade partnership should be disregarded and all transactions engaged in by Jade should be treated as being engaged in directly by the purported partners, including the Ervin LLCs. Thus, the FPAA disallowed the deductions claimed for losses purportedly incurred from the contribution of the spread transactions to Jade. The FPAA also disallowed the losses claimed by Jade and reduced Jade's claimed distributions of property to zero. The IRS also imposed accuracy-related penalties under §6662 of the Tax Code.

Subsequently, Jade filed a petition for readjustment of the partnership items of Jade in the Court of Federal Claims. The court upheld the IRS's determination, concluding that Jade had not met its burden of demonstrating that the contribution of the spread transactions to Jade objectively had economic substance. Jade Trading, 80 Fed.Cl. at 14. The court also affirmed the penalties determined by the IRS at the partnership level without considering the reasonable cause defenses that the partners might have. Id. at 60.

Jade appealed, and we have jurisdiction under 28 U.S.C. §1295(a)(3).

II

A

We review de novo the Court of Federal Claims' conclusion that the contribution of the spread transaction to Jade lacked economic substance. Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1357 (Fed.Cir.2006). However, we review the court's factual findings underlying this conclusion for clear error. SCS Hosp. Sys., Inc. v. Montefiore Hosp., 732 F.2d 1572, 1578 (Fed.Cir.1984). Finally, we review the court's jurisdictional determinations de novo. Distributed Solutions, Inc. v. United States, 539 F.3d 1340, 1343 (Fed.Cir.2008).

B

The Court of Federal Claims held that the Ervin LLCs' contributions of the spread transactions to Jade lacked economic substance. We agree.

The economic substance doctrine "require[s] disregarding, for tax purposes, transactions that comply with the literal terms of the tax code but lack economic reality." Coltec, 454 F.3d at 1352. In Coltec we discussed the economic substance doctrine in detail, leaving no question as to its viability. We explained that the doctrine "represents a judicial effort to enforce the statutory purpose of the tax code." Id. at 1353. The doctrine, "[f]rom its inception, ... has been used to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a

tax benefit." Id. at 1353-54. In Coltec, after examining cases from the Supreme Court, various courts of appeals, and our predecessor court, we concluded that the economic substance doctrine incorporated five general principles. Specifically, we opined that 1) the transaction cannot lack economic reality; 2) the taxpayer bears the burden of proving that the transaction has economic substance; 3) the economic substance of a transaction must be viewed objectively rather than subjectively; 4) the transaction to be analyzed is the one that gave rise to the alleged tax benefit; and 5) arrangements with subsidiaries that do not affect the economic interests of independent third parties deserve particularly close scrutiny. Id. at 1355-57. We also explained that "a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance." Id. at 1355.

The Ervin LLCs' transfer of the spread transactions to Jade lacked economic substance. The Ervin LLCs purchased euro call options from AIG for a premium of $15,000,020 and sold euro options to AIG for a premium of $14,850,018. However, the Ervin LLCs paid AIG only the difference-a net premium of $150,002. After contributing the spread transactions to Jade and subsequently exiting the partnership, the Ervins claimed a basis of over $15 million in their Jade interests by including only the cost of the purchased call option. As a result, the artificially

inflated basis generated a purported $14.9 million tax loss.

As the Court of Federal Claims noted, this loss was "purely fictional." JadeTrading, 80 Fed.Cl. at 45. Each Ervin LLC did not invest $15 million in the spread transaction contributed to Jade and did not lose almost $15 million upon exiting Jade. Neither option was, in fact, exercised. Thus, each Ervin LLC had a real loss of approximately $100,000 upon exiting Jade-the difference between its capital contribution of $225,000 to the Jade partnership and its redemption proceeds of $126,122 received from Jade.

Additionally, the formation of the Jade partnership appears to have had no economic purpose. The partnership did nothing to enhance the investment potential of the spread transaction. Id. at 46. However, for tax purposes, it was imperative that the individual partners contribute the spread transactions to Jade to generate the artificially inflated bases.

Also significant is the Court of Federal Claims' determination that the spread transaction was virtually guaranteed to be unprofitable. Each Ervin LLC was required to pay an $84,100 account opening fee to AIG and a $750,000 New Vista consulting fee.[5] Thus, each Ervin LLC spent at

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[5] In its findings, the Court of Federal Claims also included fees for an opinion letter prepared by Curtis Mallet. It is unclear whether each Ervin LLC was

least $834,100 for the chance at making a profit of $140,000.[6] No reasonable investor would engage in such a transaction to earn a profit. The Court of Federal Claims concluded, and we agree, that

> This transaction's fictional loss, inability to realize a profit, lack of investment character, meaningless inclusion in a partnership, and disproportionate tax advantage as compared to the amount invested and potential return, compel a conclusion that the spread transaction objectively lacked economic substance.

"required" to purchase the $100,000 tax opinion letter. However, given that the letter was requested to cover "certain aspects of United States Federal income tax in connection with (i) investments in foreign currency that [the Ervins had] made and (ii) transactions in which [they] engaged with a partnership ... that trades in foreign currency," Jade Trading, 80 Fed.Cl. at 33, it is likely that the Ervins felt compelled to purchase the letter. The inclusion or absence of this fee does not change our analysis.

Additionally, the fees listed above do not include Sentinel's 2% management fee or its 20% incentive fee, or the 5% penalty for early withdrawal from Jade (which applied if the Ervin LLCs withdrew from Jade prior to 12 months from entering the partnership, which they did).

[6] This is calculated by subtracting the cost of each spread transaction ($150,002) from its maximum payoff ($290,540) that could occur due to the different option prices.

Id. at 14. As the Court of Federal Claims found, this spread transaction and its contribution to Jade "was developed as a tax avoidance mechanism and not as an investment strategy" by the BDO Seidman accounting firm. Id.

Jade argues that the contribution of the spread transactions to Jade had economic substance because the purchased call options and the sold call options were separate assets with separate documentation and were owned by unrelated parties. The Court of Federal Claims concluded that "the economic realities of the spread transaction contributed to Jade made it impossible to delink the option pairs," explaining:

> If the Ervin LLCs had wished to hold only the long position-that is, the option they purchased from AIG-they would have faced the prospect of theoretically unlimited gain.... To obtain that position, the Ervin LLCs would have been required to pay AIG the full face amount of the premium, about $15 million each, to purchase the options. Neither the Ervin LLCs nor Jade ever had sufficient funds to make such a payment. Moreover, under this scenario, the entire amount would have been at risk; had the euro not risen to 1.084, each Ervin LLC would have lost the entire $15 million premium it paid to AIG.
>
> Had the Ervin LLCs wished to hold on the short option sold to AIG, they would

> have faced the prospect of theoretically unlimited loss, as AIG would have benefitted in any rise of the euro above 1.085, not capped in any way. Because such a transaction would be uncovered, AIG would have had extensive credit concerns. The Ervin LLCs would not have received the premiums to which they would be theoretically entitled, because AIG would have retained those premium payments as margin, because AIG would not have had the spread's protection from loss. AIG would have required that the Ervins post margin in the amount of at least $8 million each. In sum, under the agreement with AIG, the Ervins could not separate the components of the spread without AIG's permission which would not likely have been forthcoming without the required margin.

Id. at 50-51 (citations to record omitted). As the government's expert explained, "[t]he spread strategy component options were priced together, purchased together, contributed to Jade together, and closed out by Jade together, and at no time during their lives did either the Ervin LLCs or Jade have the means to separate the component options." **[JA 5817]** The Court of Federal Claims concluded that "the transactions here cannot be separated because they were totally dependent on one another from an economic and pragmatic standpoint." Id. at 51. Jade has not persuaded us that this conclusion is in error.

Accordingly, we affirm the Court of Federal Claims' judgment that the contribution of the spread transactions to Jade lacked economic substance and should be disregarded for tax purposes.

C

Jade asserts that the Court of Federal Claims does not have jurisdiction to review the penalties imposed by the IRS based on the Ervins' outside bases in Jade.

Section 6226 of the Tax Code is TEFRA's judicial review provision. Specifically, §6226(f) grants the trial court (either the Court of Federal Claims or the United States Tax Court):

> jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

26 U.S.C. §6226(f) (emphases added).[7]

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[7] Under TEFRA, a "partnership item" is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A ... provided that ... such item is more appropriately determined at the partnership level than at the partner level." 26 U.S.C.

Jade contends that because the Ervins' outside bases in Jade, upon which the assessed penalties are based, are not partnership items, there could be no penalty applicable to a partnership item to trigger the court's penalty jurisdiction under §6226(f).

The government responds that while a partner's outside basis is an affected item and thus not itself a partnership item, most (if not all) of the components of a partner's outside basis are themselves partnership items. The government further argues that since all "legal and factual determinations that underlie the determination of the amount, timing, and characterization" of partnership items are themselves partnership items, the lack of economic substance of the spread transactions contributed to Jade is a partnership item.

In a factually analogous case, the D.C. Circuit considered whether §6226(f) conferred jurisdiction on the trial court, in that case the Tax Court, to determine that the partners had no outside bases in a partnership that was disregarded for tax purposes. Petaluma FX Partners, LLC. v. Comm'r

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§6231(a)(3). TEFRA further defines two other terms, namely, a "nonpartnership item" and an "affected item." A "nonpartnership item" is one that is not a "partnership item." 26 U.S.C. §6231(a)(4). And an "affected item" is one that is affected by a "partnership item." 26 U.S.C. §6231(a)5.

of Internal Revenue Serv., 591 F.3d 649 (D.C.Cir.2010). In Petaluma, the purported partnership, Petaluma, was formed with the purpose of engaging in foreign currency option trading. Id. at 650. The partners each contributed pairs of offsetting long and short foreign currency options to become partners in Petaluma. Id. The partners increased their adjusted bases in Petaluma to reflect the long options they contributed, but they did not reduce those bases to reflect Petaluma's assumption of their short options. Id. The partners subsequently withdrew from Petaluma, which fully liquidated their interest in the partnership by distributing cash and shares of Scient stock. Id. Prior to the end of the year, the partners sold their stock, taking their adjusted bases in the distributed stock equivalent to their adjusted bases in Petaluma immediately prior to the distribution. Id. Given the inflated adjusted bases in the stock, these sales created substantial short-term capital losses that the partners claimed on their federal tax returns. Id.

The parties' arguments on appeal in Petaluma were strikingly similar to those in this case. As in the present case, Petaluma argued that outside basis is an affected item, not a partnership item and, therefore, the Tax Court had no right to determine that its partners' outside bases were zero. Id. at 654. Also similar to this case, the government conceded that outside basis is not a partnership item but then argued that outside

basis is an affected item whose elements are largely or entirely partnership items. Id.

The D.C. Circuit agreed with Petaluma, stating that "the partners' outside bases are affected items, not partnership items. Unlike partnership items, affected items are determined not at the partnership level, but at the individual partner level." Id. The court observed that not only are partnership items and affected items treated at different levels, the assessment procedures are different. Id. at 655. In the case of a partnership item, the IRS may directly assess the tax against the individual partner by making a computational adjustment-applying the new tax treatment of all partnership items to the partner's return-and the partner must bring a refund claim to challenge the computation. 26 U.S.C. §6230(c)(1). However, if the partner's liability relates to affected items, the IRS must send a notice of deficiency to that partner, thereby initiating a deficiency proceeding against him individually. 26 U.S.C. §6230(a)(2)(A)(i); see Desmet v. Comm'r of Internal Rev., 581 F.3d 297, 302 (6th Cir.2009) (explaining that the IRS has different procedures for making adjustments to a partner's tax liability depending on whether the item is a partnership item or an affected item).

The court concluded that under §6226(f) the Tax Court did not have jurisdiction to review the determination that the individual partners had no outside basis in Petaluma. The court rejected the government's contention that, although an affected

item, outside basis could be determined in the partnership-level proceeding. "The fact that a determination seems obvious or easy does not expand the court's jurisdiction beyond what the statute provides. In other words, it does not matter how low the fruit hangs when one is forbidden to pick it." Id. at 655.

We find the D.C. Circuit's reasoning persuasive and see no reason to depart from it in this case. While the parties here are different, each of the Ervins' outside basis in Jade is an affected item and thus not determined at the partnership level. See Schell v. United States, 598 F.3d 1378, 1381-82 (Fed.Cir.2009) ("An example of an 'affected item' is a partner's tax basis in his partnership interest, which is affected by partnership items such as partnership income or loss."). We also agree with the D.C. Circuit's observation:

> [N]othing about the concept of outside basis indicates that it is more appropriately determined at the partnership level. If disregarding a partnership leads ineluctably to the conclusion that its partners have no outside basis, that should be just as obvious in partner-level proceedings as it is in partnership-level proceedings. Moreover, with the invalidity of the partnership conclusively established as a partnership-level determination, there is little danger that outside basis will receive

> inconsistent treatment at the individual partner level.

Petaluma, 591 F.3d at 655.

Because outside basis is not a "partnership item," we conclude that the Court of Federal Claims lacked jurisdiction to determine that the Ervins had no outside basis in Jade.

As explained above, under §6226(f), the trial court has jurisdiction over "the applicability of any penalty ... which relates to an adjustment to a partnership item." The penalty in this case was imposed on the underpayment of income tax due to the gross valuation misstatement of the partners' outside basis in the partnership. Outside basis is an affected item, not a partnership item; thus, the penalty here relates to an adjustment of an affected item, not a partnership item. Accordingly, the trial court did not have jurisdiction over the applicability of this particular penalty.

Because it is possible that at least some portion of the penalties could have been computed without relying on the partners' outside bases, we conclude that the penalty issue should be vacated and remanded. See id. at 655-56 (remanding for a determination as to whether some of the penalties could have been assessed without partner-level computations). Remand proceedings should determine whether any penalties could have been assessed without relying on the Ervins' outside bases.

D

Finally, Jade argues that the Court of Federal Claims should have considered the Ervin's reasonable cause defenses, asserting that Temp. Treas. Reg. §301.6221-1T(c), (d) is invalid. Because we vacate that portion of the Court of Federal Claims' judgment affirming the penalties assessed against the Ervins, the validity challenge to the temporary regulation is moot at this time, and we decline to reach it. See United States v. Alaska S.S. Co., 253 U.S. 113, 116, 40 S.Ct. 448, 64 L.Ed. 808 (1920) ("[I]t is a settled principle in this court that it will determine only actual matters in controversy essential to the decision of the particular case before it."); see also United States v. UPS Customhouse Brokerage, Inc. 575 F.3d 1376, 1383 (Fed.Cir.2009) (vacating as moot the issue of whether Customs could impose penalties aggregating more than $30,000 under 19 C.F.R. §111.91 when the case was being remanded for Customs to conduct a proper analysis of whether there was in fact a violation of 19 U.S.C. §1641); Elkem Metals Co. v. United States, 468 F.3d 795, 803 (Fed.Cir.2006) (concluding that because an amount was properly excluded from constructed value, the issue of whether the party correctly reported that amount was moot and need not be decided). While the Court of Federal Claims could conclude on remand that some of the penalties could have been assessed without relying on the Ervins' outside basis and thus putting this issue back into play, the opposite is also true. Although

these issues are important to the parties and may become relevant later in this case, deciding them now would be premature.

Accordingly, we vacate that portion of the Court of Federal Claims' judgment concluding that the Ervins' partner-level defenses cannot be brought at the partnership level.

III

Because the Court of Federal Claims correctly concluded that the contribution of the spread transactions to Jade lacked economic substance, we affirm the court's denial of Jade's petition for readjustment of partnership items. However, because the Court of Federal Claims lacked jurisdiction to review the penalties imposed on the underpayment of income tax due to the gross valuation misstatement of the Ervins' outside bases in Jade, we vacate that portion of the court's judgment affirming the penalties assessed against the Ervins. Additionally, we remand this issue for the court to determine whether any part of the penalties could have been assessed without relying on the Ervins' outside bases and thus falling within the court's jurisdiction. Finally, we vacate as moot that portion of the Court of Federal Claims' judgment upholding the validity of Temp. Treas. Reg. §301.6221-1T(c), (d).

AFFIRMED-IN-PART, REVERSED-IN-PART, VACATED-IN-PART.

COSTS

Each party shall bear its own costs.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 1999

(Argued: March 1, 2000 Decided: Aug. 17, 2000)

Docket No. 97-6215

Joseph MONTI and Tita Monti,

Plaintiffs-Appellants,

-v.-

UNITED STATES OF AMERICA,

Defendant-Appellee.

Before: McLAUGHLIN, SACK, and KATZMANN, Circuit Judges.

Appeal from a judgment of the United States District Court for the Eastern District of New York (Joanna Seybert, Judge) granting the government's motion to dismiss for lack of subject matter jurisdiction. We hold that the plaintiffs' action for a federal income tax refund is not attributable to a "partnership item" for purposes of the Tax Equity and Fiscal Responsibility Act of 1982 and that the district court therefore erred in ruling that it had no jurisdiction over the action.

Reversed and remanded.

JOHN W. HUGHES, New York, NY, for Plaintiffs-Appellants.

TERESA T. MILTON, Attorney, Tax Division, Department of Justice, Washington, DC (Loretta C. Argett, Assistant Attorney General, Washington, DC, and Teresa E. McLaughlin, Attorney, Tax Division, Department of Justice, Washington, DC, on the brief; Zachary W. Carter, then-United States Attorney for the Eastern District of New York, of counsel), for Defendant-Appellee.

SACK, Circuit Judge:

The question presented by this appeal is whether a partner's claim for tax treatment consistent with that accorded other partners in a settlement with the Internal Revenue Service is a claim for a refund attributable to a "nonpartnership item" that properly can be the subject of a suit in a federal district court, or is a claim for a refund attributable to a "partnership item" about which suit in federal district court is barred. We hold that it is attributable to a nonpartnership item and that this action asserting such a claim was therefore properly instituted in the district court.

Plaintiffs-Appellants Joseph and Tita Monti, a married couple, appeal from the dismissal of their federal income tax refund action by the United States District Court for the Eastern District of

New York (Joanna Seybert, Judge). The district court held that it lacked jurisdiction over the Montis' claim because the United States has not waived sovereign immunity for refund claims attributable to "partnership items" except in very limited circumstances not applicable to the Montis' case. We hold that a refund action based on the Internal Revenue Service's failure to offer consistent settlement terms to nonsettling partners of a partnership is not attributable to a "partnership item" for purposes of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub.L. No. 97-248, 96 Stat. 324, and that the United States has therefore waived sovereign immunity with respect to such an action. Accordingly, we reverse and remand the case to the district court for adjudication of the Montis' refund action on the merits.

BACKGROUND

Overview

The Montis were limited partners in a partnership named Syn-Fuel Associates ("Syn-Fuel"). They claimed individual federal income tax deductions based on their partnership interests in Syn-Fuel for the years 1982 through 1985. In 1987 the Internal Revenue Service (the "IRS") audited Syn-Fuel pursuant to the provisions of TEFRA and, in a Final Partnership Administrative Adjustment ("FPAA"), disallowed many of the deductions. Syn-Fuel appealed the FPAA to the United States Tax Court, where it

was affirmed. See Peat Oil and Gas Assocs. v. Commissioner, 100 T.C. 271, 1993 WL 95582 (1993). This Court then affirmed the Tax Court's ruling in Ferguson v. Commissioner, 29 F.3d 98 (2d Cir.1994) (per curiam).

When the IRS enters into a settlement agreement regarding partnership taxes with one partner, it is required by TEFRA to "offer to any other partner who so requests[,] settlement terms ... which are consistent with those contained in [the] settlement agreement." I.R.C. §6224(c)(2). During the preparation of the FPAA and the subsequent litigation, many individual Syn-Fuel partners settled with the IRS. The Montis did not. The Montis' tax treatment was therefore resolved through the FPAA and the subsequent litigation. They have paid the taxes assessed to them according to the FPAA, but are now suing for a refund reflecting the consistent treatment that they assert is due to them.

In seeking a refund, the Montis allege that they were never given the statutorily required notice of the terms of one of the settlements entered into by several limited partners (the "Craig Settlement"), that the time during which they were required to file for treatment equivalent to that given to other Syn-Fuel partners under the Craig Settlement therefore never began to run, and that their current request for settlement terms consistent with the Craig Settlement therefore remains timely. The terms of the Craig Settlement are far

more favorable to the Montis than those resulting from the FPAA and the subsequent related litigation.

Sovereign Immunity

The doctrine of sovereign immunity prevents suits against the United States unless the United States has waived the immunity. See United States v. Testan, 424 U.S. 392, 399, 96 S.Ct. 948, 47 L.Ed.2d 114 (1976). The government has done so broadly with respect to federal income tax refund actions. See 28 U.S.C. §1346(a)(1); United States v. Forma, 42 F.3d 759, 763 (2d Cir.1994). There are certain kinds of refund actions, however, with respect to which the government has not waived sovereign immunity. Relevant here: "No action may be brought for a refund attributable to partnership items (as defined in [I.R.C.] section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)." I.R.C. §7422(h). Thus, if the refund the Montis seek is attributable to a partnership item other than those excepted by the statute, their action was correctly dismissed by the district court.

Statutory Framework Under TEFRA

Partnerships are generally not taxable entities. "[T]he income and expenses of the partnership normally 'flow through' to the several partners, who remain ultimately responsible for filing their own taxes." Transpac Drilling Venture 1982-12 v. Commissioner, 147 F.3d 221, 223 (2d Cir.1998).

Until the enactment of TEFRA in 1982, administrative and judicial proceedings related to partnership income were therefore conducted at the level of the individual partner. If the IRS took issue with the partnership's books or returns, it addressed the issue with each partner individually. See Chimblo v. Commissioner, 177 F.3d 119, 121 (2d Cir.1999).

Because this system proved inefficient and often led to inconsistent results, "[u]nder TEFRA, one proceeding determines how partnership items will be reported on all of the partners' individual returns. The statute requires partners, on their personal returns, to treat partnership items consistently with the items' treatment on the partnership return." Olson v. United States, 37 Fed. Cl. 727, 731 (1997), aff'd, 172 F.3d 1311 (Fed.Cir.1999). Individual taxpayers still pay the relevant taxes--the partnership does not pay income tax--but determinations as to the amount of tax attributable to partnership items are made at the partnership level. See Randell v. United States, 64 F.3d 101, 103-04 (2d Cir.1995), cert. denied, 519 U.S. 815, 117 S.Ct. 65, 136 L.Ed.2d 26 (1996).

TEFRA defines a partnership item as follows:

> The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the

> Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

I.R.C. §6231(a)(3). A "nonpartnership item" is defined as "an item which is (or is treated as) not a partnership item." I.R.C. §6231(a)(4).

If the IRS decides to examine a partnership's tax return, each partner can opt either to participate in the proceeding or seek to settle. Absent a settlement with all the partners, the proceeding results in an FPAA that must be sent to the partnership's Tax Matters Partner ("TMP") and to all "notice partners" who, because of the magnitude of their interest in the partnership are, by statute, entitled to direct notice from the IRS. See I.R.C. §6223(a)(2). The TMP is responsible for notifying non-notice partners, such as the Montis, of the FPAA. The FPAA may then be appealed by the TMP or any notice partner to the Tax Court, a federal district court, or the Court of Claims, see Chimblo, 177 F.3d at 121, with all other partners who have not settled being treated as parties to such an action, see I.R.C. §6226(c). Unless a partner has opted out of the FPAA process by settling, that partner is bound by the results of this process. Because the FPAA determines the tax treatment of partnership items, a partner cannot bring a refund action attributable to anything litigated during the FPAA process. Allowing such lawsuits would undercut TEFRA's goal of

consolidating the treatment of partnership items at the partnership level. See Kaplan v. United States, 133 F.3d 469, 473 (7th Cir. 1998) ("TEFRA requires that all challenges to adjustments of partnership items be made in a single, unified agency proceeding; indeed, this is the key component of TEFRA that yields the desired benefits of economy and consistency.").[1]

A partner who settles with the IRS under I.R.C. §6224(b) thereby removes him or herself from the partnership-level FPAA proceedings. But the Internal Revenue Code provides that if the IRS enters into such a settlement with one or more partners, it is required to "offer to any other partner who so requests [,] settlement terms ... which are consistent with those contained in [the] settlement agreement." I.R.C. §6224(c)(2). In other

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[1] By statute, a partner may bring suit for a refund attributable to a partnership item, however, if "the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement", I.R.C. §6230(c)(1)(B), or if the partner's request for an administrative adjustment is denied, see I.R.C. §6228(b). These suits are permitted because the issue of how the partnership's tax status applies to a particular partner will vary from partner to partner. If the IRS makes a computational mistake when applying the FPAA to an individual partner, or denies a partner's request for an adjustment, allowing that partner to sue for a refund is thus consistent with the goals of TEFRA. See Kaplan, 133 F.3d at 472-73.

words, the IRS cannot play favorites; if one partner settles, it must offer the same settlement terms to all partners. If the IRS does settle the tax liability of a partner it must, under Tax Court Rule 248(c)(2), serve notice of the settlement on the partnership's TMP within seven days of executing the agreement. The TMP is then responsible for notifying the other partners of the settlement. See I.R.C. §6223(g); 26 C.F.R. §301.6223(g) 1T(b)(1)(iv) Thereafter, any partner may request settlement terms consistent with those accorded to the settling partner or partners at any time before the "later of--(i) The 150th day after the day on which the notice of final partnership administrative adjustment is mailed to the tax matters partner, or (ii) The 60th day after the day on which the settlement agreement was entered into." 26 C.F.R. §301.6224(c)-3T(c)(3). When a partner settles with the IRS with respect to an item, that item ceases to be a "partnership item" and becomes a "nonpartnership item" with respect to the settling partner. See I.R.C. §6231(b)(1)(C).

Factual Background

The Montis acquired their partnership interest in Syn-Fuel in 1982. They claimed deductions of between $200,000 and $245,000 on each of their 1982, 1983, 1984 and 1985 joint tax returns. The IRS audited Syn-Fuel in 1987. It disallowed the deductions Syn-Fuel had claimed and which its partners had correspondingly claimed on their own behalf. On March 11, 1988, the IRS issued an

FPAA outlining the tax treatment that would be accorded to the partnership. On August 2, 1988, Syn-Fuel's TMP appealed the FPAA to the Tax Court.

In mid-1992, Dennis Brager, a lawyer who represented the Montis and some of the other Syn-Fuel partners in their Syn-Fuel dealings, negotiated the Craig Settlement on behalf of other Syn-Fuel partners with Lawrence Dorr, the IRS Appeals Officer assigned to the case. Although negotiations for the Craig Settlement were completed in mid-1992, the settling partners did not formally enter into it until December 1992. Under Tax Court Rule 248(c)(2), the IRS had seven days thereafter in which to notify Syn-Fuel's TMP of the Craig Settlement. The IRS failed to do so. Indeed, the IRS did not formally notify anyone about the settlement until March 10, 1993, when it sent a letter to Brager and the Syn-Fuel TMP stating that the Craig Settlement had been consummated seventy days earlier, on December 31, 1992.

After receiving the March 10, 1993 letter notifying his clients of the Craig Settlement, Brager had a conversation with Dorr. Dorr told Brager that Brager's clients, other than those who were part of the Craig Settlement, had only sixty days after the date of the Craig Settlement to request consistent terms, and that those sixty days had expired on or about March 1, 1993--sixty days after December 31, 1992 and nine days before

Dorr's letter to Brager officially noting the fact of the settlement. The IRS thus took the position that the Montis' period for requesting consistent terms had ended nine days before they were notified through their counsel or the TMP that it had begun.

On April 1, 1993, the Tax Court upheld the FPAA, see Peat Oil and Gas Assocs. v. Commissioner, 100 T.C. 271, 1993 WL 95582 (1993), making the terms of the Craig Settlement, which were more favorable to partners than were the terms of the FPAA, attractive to non-settling partners such as the Montis. On April 30, 1993, Brager therefore wrote to his clients advising them that although the IRS had taken the position that the period for requesting terms consistent with the Craig Settlement was over, he personally believed that all Syn-Fuel partners were entitled to consistent terms and recommended that they request them. Brager included a form for requesting consistent terms with his letter and instructed his clients to fill it out by May 10, 1993, which he figured would be sixty days after March 10, 1993, the date of the IRS letter formally giving notice of the Craig Settlement. Brager made this recommendation despite the fact that the IRS's stated position was that any requests received after March 1, 1993 would be untimely. The Montis did not execute the form requesting consistent terms.

On June 10, 1993, Dorr wrote another letter to Brager. He confirmed his earlier position but said that "in the interest of fairness" the IRS would accept requests for consistent terms received within sixty days of the March 10 letter. But by the time of the June 10 letter, that period had also expired. In other words, the IRS was saying on June 10 that in the interest of "fairness" the Montis would have until May 10 to request consistent terms. Only those partners who had followed Brager's advice and ignored the IRS's earlier statements would thus be entitled to consistent terms. The Montis and any partners similarly situated were, as far as the IRS was concerned, out of luck.

Nearly a year later, on May 20, 1994, this Court affirmed the Tax Court's decision finalizing the FPAA's treatment of Syn-Fuel partnership items. See Ferguson v. Commissioner, 29 F.3d 98 (2d Cir.1994) (per curiam). On June 28, 1994, the IRS therefore sent the Montis a notice of computational adjustment informing them how much they owed in back taxes as a result of the partnership's tax treatment under the FPAA.

Five months later, on December 2, 1994, the Montis finally requested settlement terms consistent with the Craig Settlement and simultaneously paid all the back taxes assessed against them by the IRS as a result of the FPAA proceedings. They then claimed refunds for the amounts paid beyond what they would have had to

pay under the terms of the Craig Settlement. On December 9, 1994, the IRS denied the Montis' request for consistent terms on the ground that their request was untimely because it had been filed more than sixty days after the execution of the Craig Settlement.

Having been turned down for consistent treatment by the IRS, the Montis brought the current refund action in the United States District Court for the Eastern District of New York. The government moved to dismiss, arguing that because the action was for a refund "attributable to partnership items" under I.R.C. §7422(h) that did not fall within the exception for overpayments "attributable to the application ... of a settlement" under I.R.C. §6230(c)(1)(B), the United States had not waived sovereign immunity with respect to the suit. The district court agreed and dismissed the action for lack of subject matter jurisdiction. See Monti v. U.S., 976 F.Supp. 157 (E.D.N.Y.1997).

On appeal, the Montis argue that the denial of their statutory right to request consistent terms is not a partnership item and that the refund they seek is therefore not attributable to a partnership item. In the alternative, they argue that if their right to request consistent terms is a partnership item their refund is nevertheless one "attributable to the application ... of a settlement" to them. They further assert that we should grant summary judgment in their favor because neither they nor the TMP has ever received notice of a sixty-day

period in which to request consistent terms. Because such a sixty-day period has not begun to run, they argue, they are entitled, as a matter of law, to terms consistent with those contained in the Craig Settlement.

DISCUSSION

I. Standard of Review

The issue that we decide on this appeal, whether the complaint was properly dismissed pursuant to Fed.R.Civ.P. 12(b)(1) because the United States has not waived sovereign immunity with respect to the claim asserted, is one of pure statutory interpretation. We therefore review the decision of the district court de novo. See Up State Fed. Credit Union v. Walker, 198 F.3d 372, 374 (2d Cir.1999).

II. Is the Claim Attributable to a Partnership Item?

The Montis argue that they had a right to settlement terms consistent with those in the Craig Settlement. The IRS denied them that right, they assert, by initially failing to give them notice of the Craig Settlement and by subsequently telling them that their time for requesting consistent terms had expired. They argue that their claim that they were deprived of their right to consistent terms is not attributable to a partnership item because a decision on that issue depends on facts unique to them and unconnected with the resolution of partnership-wide issues.

They conclude that because the refund they seek is attributable to this nonpartnership item the district court had jurisdiction over their claims. We agree.

Partnership items are those "more appropriately determined at the partnership level than at the partner level." I.R.C. §6231(a)(3). Since the question of whether a particular partner has properly been offered and is entitled to consistent terms depends on facts specific to that partner and his or her dealings with the IRS, there is no apparent reason why determination of the item is "more appropriate[ ]" at the partnership level.

Moreover, "[t]he items ... more appropriately determined at the partnership level" are set forth in the regulations implementing TEFRA. See 26C.F.R. §301.6231(a)(3)-1 They include the income, gains, losses, deductions, and credits of the partnership, and distributions received and contributions made by it. See id. The right of individual partners to request consistent settlement terms, as provided for in I.R.C. §6224(c)(2), is not on the list.

Finally, under TEFRA, a partnership item is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A [of the Internal Revenue Code]." I.R.C. §6231(a)(3). A partner's right to consistent settlement terms is located in subtitle F.

The alleged deprivation of the Montis' right to consistent terms is thus not a partnership item. Their claim for a refund is attributable to this nonpartnership item, not a partnership item, such as the amount of income of or the propriety of deductions taken by Syn-Fuel.

At some level of generality, of course, most refund actions involving the taxation of a partnership can be described as seeking a refund "attributable to partnership items," I.R.C. §7422(h). In the absence of partnership income or loss, both partnership items, there would be no taxes in the first place; in the absence of claimed partnership deductions, perhaps no FPAA. But such a reading of the phrase "attributable to partnership items" would make most or all refund claims arising out of the taxation of partnerships, even those entirely about and entirely dependent on facts peculiar to a single partner, claims for refunds "attributable to partnership items." To blur or erase in that manner the distinction between proceedings involving partnership items and those involving nonpartnership items would be contrary to the system of separate treatment of partnership and nonpartnership issues Congress established by enacting TEFRA.

The Internal Revenue Code provides that with exceptions not relevant to this issue, "no action may be brought for a refund attributable to partnership items." I.R.C. §7422(h). We conclude that the Montis' action is not "for a refund

attributable to partnership items" and therefore may be brought in federal district court.

III. The Opinion of the District Court

The district court held that the right to consistent settlement terms is a partnership item. See Monti, 976 F.Supp. at 161-62. Its reasons for doing so are unpersuasive.

First, as the district court observed, I.R.C. §6224(c)(2) does refer to a partner's right to enter into an agreement consistent with the terms of a settlement made "with respect to partnership items." See id. at 161. But it does not follow, as the district court held, that the §6224(c)(2) right is itself a partnership item. The §6224(c)(2) right is an individual right to consistent terms. One partner's right to settlement terms consistent with those granted to another partner is not a partnership item, because the question posed requires consideration of the relationship between one partner's situation and another's and the individual's, rather than the partnership's, communications with the IRS. The facts needed to determine whether consistent terms were offered are facts about the partner, not facts about the partnership.

Second, the district court acknowledged that settlement agreements differ from partner to partner but reasoned that that does not indicate the involvement of a nonpartnership item because "at the partnership level proceeding, [too,] each

partner will owe a different amount in taxes based on [his or her] pro rata share of the partnership." Monti, 976 F.Supp. at 161. But at the partnership-level proceeding, determinations are made as to the tax treatment of partnership items; that treatment is then applied to the partners on a partner-by-partner basis depending on the interest of each in the partnership. Determinations as to whether individual partners received proper notice are not made on a partnership basis and then applied to individual partners. They are made on a partner-by-partner basis.

Third, the district court feared that allowing partners to settle "outside the partnership level would ... undermine the consistency and uniformity of resolving all the partners[']claims of partnership items together." Id. at 162. But whenever the IRS settles with an individual partner, that partner is treated differently than the partners who choose not to settle. That does not undercut TEFRA's uniformity goal. The statute creates a system under which all partnership items are resolved in a single proceeding unless a partner settles with the IRS and thereby withdraws from the proceeding. The fact that individual partners may be given the opportunity to withdraw from the FPAA process is not inconsistent with the principle that partnership items are to be treated uniformly in the process.

Nor do plaintiffs like the Montis get "an unlimited number of bites at the apple," as the

district court concluded, id. at 162 n. 2, if the right to consistent terms is a nonpartnership item. If the IRS had simply fulfilled the requirement that it give partners timely notice of settlement, the Montis would have been compelled to decide within a specified time period either to request treatment consistent with the Craig Settlement terms or be bound by the FPAA. It was the IRS's alleged failure to give notice before the conclusion of the FPAA and the litigation that confirmed it that had the effect of allowing the Montis to track the FPAA litigation and compare its results to the terms of the Craig Settlement before choosing whether to request consistent treatment. True, in this case the Montis may be allowed to place a bet on a race that has already been run, but that is only because the IRS never bothered to announce last call.

IV. The Prochorenko Litigation

Finally, we take note of another lawsuit stemming from the Syn-Fuel FPAA and the Craig Settlement that also involved Brager clients. See Prochorenko v. United States, 45 Fed. Cl. 494 (2000). A set of Syn-Fuel partners, a married couple named Collitti, made a claim strikingly similar to the Montis' claim here: On the basis of facts peculiar to them, the Collittis asserted that they were entitled to terms consistent with the Craig Settlement. Instead of litigating their claim to judgment as did the Montis, however, the Collittis settled it with the IRS on terms similar to those contained in the Craig Settlement. See id. at

497. In 1997, yet another couple of Syn-Fuel partners, the Prochorenkos, learned of the IRS's agreement with the Collittis and sought consistent treatment, not with the Craig Settlement, but with the Collitti settlement. See id.

The IRS argued that the Prochorenkos were not entitled to treatment consistent with the Collitti settlement because (i) partners are only entitled to terms consistent with those contained in "a settlement agreement ... with respect to partnership items," I.R.C. §6224(c)(2), and (ii) the settlement of the Collittis' claim for consistent treatment was not a "settlement agreement ... with respect to partnership items." In support of these propositions, the IRS asserted that

> [a] dispute over whether there is a right to consistent terms [i.e., the Collittis's dispute with the IRS] is not a dispute over a "partnership item" because each partner's claim would depend upon facts peculiar to that partner-- e.g., whether that partner had made a timely request for an offer of consistent terms.

The Court of Claims, ruling in favor the IRS, agreed. See id.

The argument made by the IRS in *Prochorenko* is difficult to square with the argument made by the IRS here. Both the Collittis and the Montis had what the IRS described in the Prochorenko litigation as "a dispute [with the IRS] over whether

[they have] a right to [terms] consistent" with the Craig Agreement. If the Collittis' settlement of that dispute was not a settlement "with respect to partnership items," I.R.C. §6224(c)(2), then it would appear that the Montis' attempt to resolve a virtually identical dispute in court is not an action for "a refund attributable to partnership items", I.R.C. §7422(h). There is a difference, of course, between the words "with respect to partnership items" and the words "attributable to partnership items," but we fail to see any significance in that difference here. The Court of Claims's conclusion that the Collittis' settlement of their claim for treatment consistent with the Craig Settlement was not a settlement "with respect to partnership items" thus reinforces our conclusion that the Montis' claim for treatment consistent with the Craig Settlement was not made in an action for "a refund attributable to partnership items."

V. Summary Judgment

The parties each claim that if the district court had subject matter jurisdiction, as we now hold that it did, they are entitled to summary judgment. Because it granted the government's motion to dismiss, the district court never reached that issue. We think it the better course for the district court to decide the issue on a complete record and full briefing rather than for us to do so in the first instance. See Aardwoolf Corp. v. Nelson Capital

Corp., 861 F.2d 46, 49 (2d Cir.1988). We remand the case to the district court for that purpose.

CONCLUSION

The logic of deeming a dispute over the right to consistent terms a dispute over a nonpartnership item is compelling.

> Because the purpose of [I.R.C.] section 7422(h) [depriving federal district courts of subject matter jurisdiction in tax refund suits attributable to partnership items] is evidently to prevent an individual partner's refund action from interfering with the partnership level determination of partnership items, that bar becomes unnecessary when the partnership level proceeding has in some sense concluded.

Alexander v. United States, 44 F.3d 328, 331 (5th Cir.1995). The Montis' request for terms consistent with the Craig Settlement would not "interfer[e] with the partnership level determination of partnership terms." Id. They do not seek to relitigate, or renegotiate, the tax treatment of any partnership items. They want only to argue that their request for consistent settlement terms was timely because they never received adequate or timely notice. That is not an issue that can be resolved at the partnership level.

For the foregoing reasons, we reverse the district court's judgment dismissing this action for want of subject matter jurisdiction and remand for

the district court to entertain and decide the parties' cross- motions for summary judgment on the merits.

United States Court of Appeals for the District of Columbia Circuit.

Argued September 24, 2009

Decided January 12, 2010

No. 08-1356

PETALUMA FX PARTNERS, LLC AND RONALD SCOTT VANDERBEEK, A PARTNER OTHER THAN THE TAX MATTERS PARTNER, APPELLANTS

v.

COMMISSIONER OF INTERNAL REVENUE SERVICE, APPELLEE

Appeal from the United States Tax Court

Edward M. Robbins Jr. argued the cause and filed the briefs for appellants.

Sheldon M. Kay, *Thomas A. Cullinan*, and *Julie P. Bowling* were on the brief for *amicus curiae* AJF-1, LLC in support of appellants.

Joan I. Oppenheimer, Attorney, U.S. Department of Justice, argued the cause for appellee. With her on the brief were *Gilbert S. Rothenberg*, Acting Deputy Assistant Attorney General, and *Richard Farber*, Supervisory

Attorney. *Judith A. Hagley*, Attorney, entered an appearance.

Before: SENTELLE, *Chief Judge*, and GRIFFITH and KAVANAUGH, *Circuit Judges*.

Opinion for the Court filed by *Chief Judge* SENTELLE.

SENTELLE, Chief Judge: Petaluma FX Partners, LLC appeals from the Tax Court's decision that it had jurisdiction over several partnership-level determinations and that valuation misstatement penalties applied. Specifically, the Tax Court held that it had jurisdiction to determine that Petaluma was a sham, lacked economic substance, and should be disregarded for tax purposes; that Petaluma's partners had no outside basis in the disregarded partnership; and that the gross valuation misstatement penalty applied. *Petaluma FX Partners, LLC v. Comm'r*, 131 T.C. 9, 2008 WL 4682543 (U.S.Tax Ct. Oct.23, 2008). For the reasons explained below, we affirm the Tax Court's holding that it had jurisdiction to determine that Petaluma was a sham and should be disregarded for tax purposes, but reverse its holding that it had jurisdiction to determine that Petaluma's partners had no outside basis in the partnership. In addition, we set aside the Tax Court's holding that it had jurisdiction to determine whether accuracy-related penalties applied and that the valuation misstatement penalties did apply in this case.

I. Background

A. Factual Background

This case involves a "Son of BOSS" tax shelter. Like many of its kin, this tax shelter employs a series of transactions to create artificial financial losses that are used to offset real financial gains, thereby reducing tax liability. In 2000, the Internal Revenue Service ("IRS") identified Son of BOSS tax shelters as abusive transactions. I.R.S. Notice 2000-44, 2000-2 C.B. 255; *see also Desmet v. Comm'r,* 581 F.3d 297, 299 (6th Cir.2009). The facts of this case illustrate how this shelter works. We rely primarily on the Tax Court's description of the facts, which is undisputed. *Petaluma,* 2008 WL 4682543, at * 1-3. Petaluma, a purported partnership, was formed on August 18, 2000. Its ostensible purpose was to engage in foreign currency option trading. On October 10, 2000, Ronald Thomas Vanderbeek and Ronald Scott Vanderbeek (collectively, "the Vanderbeeks") each contributed pairs of offsetting long and short foreign currency options to become partners of Petaluma. The Vanderbeeks increased their adjusted bases in Petaluma to reflect the long options they contributed, but did not reduce those bases to reflect Petaluma's assumption of their short options. On December 12, 2000, the Vanderbeeks withdrew from Petaluma, which fully liquidated their interests in the partnership by

distributing cash and shares of Scient stock[1] to them. In keeping with 26 U.S.C. §732(b), they took adjusted bases in the distributed stock equivalent to their adjusted bases in Petaluma immediately prior to the distribution. On December 26, 2000, the Vanderbeeks sold their Scient stock. Given their inflated adjusted bases in the stock, these sales created substantial short-term capital losses that the Vanderbeeks subsequently claimed on their 2000 federal income tax returns. For example, Ronald Thomas Vanderbeek sold his Scient stock for $122,528 and claimed a short-term capital loss of $17,776,360, which conveniently offset $14,472,420 in longterm capital gains. Likewise, Ronald Scott Vanderbeek sold his Scient stock for $39,410 and claimed a resulting short-term capital loss of $7,631,542, thereby offsetting long-term capital gains of $6,191,778.

B. Statutory Background

Although partnerships do not pay federal income taxes, they must file annual informational returns reporting income, loss, deductions, and credits. 26 U.S.C. §§701, 6031(a); Treas. Reg. §301.6231(a)(3)-1(a)(1)(i). The partners are then responsible for reporting their distributive shares of the partnership's income or loss on their individual federal income tax returns. 26 U.S.C. §§701-702, 704. Congress established the current

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[1] The stock is not further identified in the parties' submissions.

framework for adjudicating partnership-related tax matters in the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub.L. No. 97-248, §402, 96 Stat. 324, 648-67 (codified as amended at 26 U.S.C. §§6221-6232). Prior to TEFRA, all partnership items were determined at the individual taxpayer level, which often required duplicative proceedings for different partners and sometimes resulted in inconsistent treatment of partnership items from partner to partner. Under TEFRA, partnership items are now determined in unified partnership-level audit and judicial proceedings. 26 U.S.C. §6221. When the IRS disagrees with how a partnership return reports partnership items, it may commence an administrative proceeding by issuing a notice of final partnership administrative adjustment ("FPAA") to the partners. §6223(a), (d). Once an FPAA is mailed, the partnership's tax matters partner has 90 days to file a petition for readjustment of partnership items. §6226(a). If the tax matters partner does not file within that period, any other partner who received the FPAA has an additional 60 days to file a petition. §6226(b)(1). Once a petition has been filed, the reviewing court has jurisdiction to determine all partnership items for the partnership taxable year addressed by the FPAA. §6226(f).

C. The FPAA and the Tax Court's Decision

On April 2, 2001, Petaluma filed a Form 1065 partnership return for its 2000 taxable year. The

Commissioner issued an FPAA to the Petaluma partners on July 28, 2005. The FPAA disallowed all partnership items reported on Petaluma's return, reducing them from the amount Petaluma originally claimed to zero. The FPAA also listed "Outside Partnership Basis," which was not originally reported on Petaluma's partnership return, and reduced its value from $24,943,505 to $0. In addition, it included a section titled "EXHIBIT A-Explanation of Items," which determined that Petaluma's existence as a partnership had not been established, that it was formed solely for tax avoidance, that it was a sham and lacked economic substance, and that it should therefore be disregarded for tax purposes. The Explanation also determined that Petaluma's partners "have not established adjusted bases in their respective partnership interests in an amount greater than zero." Finally, the Explanation determined that various accuracy-related penalties set forth in 26 U.S.C. §6662(a) applied to all underpayments of tax attributable to these adjustments. On December 30, 2005, Ronald Scott Vanderbeek, a Petaluma partner who was not the tax matters partner, filed a petition for readjustment with the Tax Court.

In the Tax Court, Petaluma and the Commissioner entered a settlement of stipulated issues in which Petaluma conceded that the reduction of the line items in its partnership return to zero was appropriate. Petaluma retained just two arguments-first, that the Tax Court lacked

jurisdiction to consider certain issues in the FPAA, and second, that the valuation misstatement penalties did not apply. Both parties moved for summary judgment, and the Tax Court granted summary judgment for the Commissioner on October 23, 2008.

In its opinion, the Tax Court first held that it had jurisdiction to determine whether Petaluma should be disregarded for tax purposes. It reasoned that "the determination whether Petaluma is a sham, lacks economic substance, or otherwise should be disregarded for tax purposes is a partnership item over which we have jurisdiction." *Petaluma,* 2008 WL 4682543, at *9. Second, it held that because Petaluma had been disregarded for tax purposes, the court had jurisdiction to determine that the partners' outside bases in the partnership were zero because "there can be no adjusted basis in a disregarded partnership." *Id.* at *10. Third, the court held that it had jurisdiction over the accuracy-related penalties because §6226(f) gave it jurisdiction to determine "the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item." *Id.* at *11-12 (quoting 26 U.S.C. §6226(f)). Fourth, the court held that "the gross valuation [misstatement] penalty applies when the adjusted basis of property is reduced to zero because a transaction was disregarded as a sham or lacking economic substance and the taxpayer claims an adjusted basis in the property

of a greater amount." *Id.* at * 14. Petaluma timely appealed.

II. Analysis

A. Jurisdiction and Standard of Review

Petaluma filed a petition for readjustment of partnership items with the Tax Court under 26 U.S.C. §6226. The Tax Court's decisions concerning such petitions are generally reviewed by the U.S. Court of Appeals for the circuit in which the partnership's principal place of business is located. §7482(b)(1)(E). When a partnership has no principal place of business, as is the case here, the Tax Court's decision "may be reviewed by the Court of Appeals for the District of Columbia." §7482(b)(1). We review the Tax Court's decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." §7482(a)(1). Since the facts of this case are undisputed, we review the questions of law it presents de novo. *Andantech L.L.C. v. Comm'r,* 331 F.3d 972, 976 (D.C.Cir.2003).

B. Disregarding the Partnership

Petaluma contends that the Tax Court erred in holding that it had jurisdiction to determine that the partnership was a sham, lacked economic substance, and should be disregarded for tax purposes. Under TEFRA, a court considering a petition for readjustment has "jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the

notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item." 26 U.S.C. §6226(f). Petaluma argues that the Tax Court had no jurisdiction to determine that it was a sham and lacked economic purpose because that determination was not a "partnership item" within the meaning of §6226(f). We disagree.

(1) Section 6233

The jurisdiction of the Tax Court over this case is governed by 26 U.S.C. §6233. That section addresses instances in which a partnership return is filed, but the purported partnership either does not exist or is not actually a partnership. In those situations, §6233 mandates that TEFRA's provisions still apply "to the extent provided in regulations." *Id.* The relevant regulations state that "[a]ny final partnership administrative adjustment or judicial determination ... may include a determination that the entity is not a partnership for such taxable year." Temp. Treas. Reg. §301.6233-1T(a). Under the statutory authority of §6233, this regulation explicitly authorized the Tax Court to determine that Petaluma was not a partnership for the 2000 taxable year.

(2) Partnership Items

The next question raised by Petaluma's argument is whether the sham determination was a partnership item. The Internal Revenue Code states that "partnership item" means "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level." 26 U.S.C. §6231(a)(3). Thus a partnership item must be (1) "required to be taken into account ... under any provision of subtitle A" and (2) identified by regulation as "more appropriately determined at the partnership level." *Id.* We conclude that the determination that Petaluma was not a valid partnership meets both elements of this test.

(a) Required to Be Taken into Account Under Subtitle A

For the validity of a partnership to be a partnership item, it must be "required to be taken into account ... under any provision of subtitle A," which is the subtitle concerning income taxes. We have little difficulty concluding that application of the income tax provisions of Subtitle A to the tax liability of a taxpayer who receives income from a purported partnership entails a determination of the validity of that partnership. As the Eighth Circuit has stated, "When filling out individual tax

returns, the very process of calculating an outside basis, reporting a sales price, and claiming a capital loss following a partnership liquidation presupposes that the partnership was valid." *RJT Investments X v. Comm'r,* 491 F.3d 732, 736 (8th Cir.2007). Thus the first requirement of the test is met.

(b) More Appropriately Determined at the Partnership Level

In arguing that the second requirement is not met, Petaluma urges that the term "item" should be interpreted narrowly, arguing that it only includes accounting elements such as income, deductions, credit, gain, loss, and basis. As Petaluma concedes, however, the Code does not define "item." Moreover, Petaluma's attempt to cabin the meaning of "partnership item" ignores the statute's plain language authorizing the Secretary to promulgate regulations that flesh out the definition of that term. §6231(a)(3). The regulations that fulfill that mandate give examples of partnership items that include "[t]he partnership's method of accounting, taxable year, and inventory method." Treas. Reg. §301.6231(a)(3)-1(b). These examples make clear that the meaning of "partnership item" extends well beyond technical accounting elements.

Furthermore, the regulations state that the definition of partnership item includes "the legal and factual determinations that underlie the determination of the amount, timing, and

characterization of items of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b). The determination that a valid partnership exists is a *sine qua non* for determining the amount and characterization of all other partnership items. For example, determining whether there is a valid partnership necessarily controls whether there can be partnership income, partnership gain, partnership losses, and so forth. This regulation establishes that the validity of a partnership is "more appropriately determined at the partnership level," thereby meeting the second requirement of the partnership item test. Thus the determination that a partnership is a sham and lacks economic substance is a partnership item because it is a legal determination that underlies the amount and characterization of other partnership items. *RJT Investments X,* 491 F.3d at 737-38; *Keener v. United States,* 551 F.3d 1358, 1366 (Fed.Cir.2009) (stating that "the nature of a partnership's transaction-and, specifically, whether a partnership transaction is a 'sham'-is a partnership item").

Logically, it makes perfect sense to determine whether a partnership is a sham at the partnership level. A partnership cannot be a sham with respect to one partner, but valid with respect to another. In addition, this conclusion is unsurprising given that this court has affirmed the Tax Court's determinations that a partnership should be disregarded for tax purposes on several prior occasions. *Andantech L.L.C. v. Comm'r,* 331

F.3d 972, 980 (D.C.Cir.2003); *ASA Investerings P'ship v. Comm'r*, 201 F.3d 505, 506 (D.C.Cir.2000). Based on §6233, its implementing regulations, and the regulations elucidating the meaning of "partnership item," we hold that the determination that Petaluma was a sham, lacked economic substance, and should be disregarded for tax purposes is a partnership item. Given the Tax Court's jurisdiction under §6226(f) to determine all partnership items, we conclude that the Tax Court acted within its jurisdiction when it determined that Petaluma was not a valid partnership and should be disregarded for tax purposes.

C. Outside Basis

Petaluma also argues that the Tax Court erred in holding that it had jurisdiction to determine that Petaluma's partners had no outside basis in the disregarded partnership. An "outside basis" is the value assigned to a partner's investment in his or her partnership interest. *See American Boat Co. v. United States*, 583 F.3d 471, 474 n. 1 (7th Cir.2009). Under §6226(f), a court reviewing a petition for readjustment of partnership items only has jurisdiction to determine "partnership items." Under TEFRA, every item that is not a partnership item is considered a "nonpartnership item." §6231(a)(4). Items that are affected by one or more partnership items are "affected items." §6231(a)(5). Petaluma argues that outside basis is an affected item, not a partnership item, and therefore the Tax Court had no right to determine

that its partners' outside bases were zero. We agree.

On appeal the Commissioner concedes that outside basis is not a partnership item in this case. Instead, he asserts that outside basis is an affected item whose elements are mainly or entirely partnership items. He maintains that the Tax Court had jurisdiction to state the "obvious conclusion" that a partner cannot have any basis in a disregarded partnership. The correctness of this conclusion is immaterial, however, for the question is not whether the Tax Court's determination was correct, but whether the Tax Court had jurisdiction to make that determination at all in this partnership-level proceeding.

Here, the partners' outside bases are affected items, not partnership items. Unlike partnership items, affected items are determined not at the partnership level, but at the individual partner level. Once the partnership items have been finalized, the IRS may make a corresponding "computational adjustment" to each partner's tax liability. 26 U.S.C. §6230(c)(1)(A)(ii); §6231(a)(6). When a computational adjustment directly increases a partner's tax liability, the IRS can assess the tax and the partner must bring a refund claim to challenge the computation. §6230(c)(1). When a computational adjustment's effect indirectly increases a partner's tax liability and necessitates partner-level determinations concerning affected items, however, the IRS must

issue a notice of deficiency, and normal deficiency procedures apply. §6230(a)(2)(A)(i); *Desmet v. Comm'r*, 581 F.3d 297, 302 (6th Cir.2009) (describing these two assessment procedures).

Under §6226(f), the Tax Court had jurisdiction to determine partnership items, but it did not have jurisdiction to determine affected items. We have already rejected the Tax Court's conclusion that outside basis was a partnership item in this case, and we likewise reject the Commissioner's contention that outside basis, although it is an affected item, could nonetheless be determined in the partnership-level proceeding. The fact that a determination seems obvious or easy does not expand the court's jurisdiction beyond what the statute provides. In other words, it does not matter how low the fruit hangs when one is forbidden to pick it. We hold that the Tax Court had no jurisdiction to determine that Petaluma's partners had no outside basis in the disregarded partnership. Finally, we note that nothing about the concept of outside basis indicates that it is more appropriately determined at the partnership level. If disregarding a partnership leads ineluctably to the conclusion that its partners have no outside basis, that should be just as obvious in partner-level proceedings as it is in partnership-level proceedings. Moreover, with the invalidity of the partnership conclusively established as a partnership-level determination, there is little danger that outside basis will receive

inconsistent treatment at the individual partner level.

D. Penalties

Petaluma also challenges the Tax Court's jurisdiction over accuracy-related penalties. The FPAA determined that "the accuracy-related penalty under Section 6662(a) of the Internal Revenue Code applies to all underpayments of tax attributable to adjustments of partnership items of Petaluma FX Partners, LLC." Petaluma argues that since the Tax Court lacked jurisdiction to determine outside basis, it also lacks jurisdiction to determine that penalties apply with respect to outside basis because those penalties do not relate to an adjustment to a partnership item. We agree. As the Tax Court noted, penalties were formerly determined at the partner level. *Petaluma,* 2008 WL 4682543, at *11; *American Boat Co. v. United States,* 583 F.3d 471, 478 (7th Cir.2009). In the Taxpayer Relief Act of 1997, Pub.L. No. 105-34, §1238, 111 Stat. 788, 1026, Congress amended §6221 and §6226(f) so that penalties relating to adjustments to partnership items would be determined at the partnership level. *American Boat Co.,* 583 F.3d at 478. Section 6221 now states that "the tax treatment of any partnership item (*and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item*) shall be determined at the partnership level" (emphasis added). Likewise, §6226(f) now provides that a

court reviewing a petition for readjustment has "jurisdiction to determine ... *the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item*" (emphasis added).

The Tax Court held that its determination that Petaluma should be disregarded for tax purposes sufficed to give it jurisdiction over accuracy-related penalties. *Petaluma,* 2008 WL 4682543, at * 12. We disagree. True, the determination that Petaluma should be disregarded for tax purposes is a partnership item, but the outside bases of the partners are affected items to be resolved at the partner level. Neither the Tax Court nor the Commissioner on appeal have forwarded any basis for the jurisdiction of the Tax Court over affected items in this proceeding. As it is not clear from the opinion, the record, or the arguments before this court that the penalties asserted by the Commissioner and ordered by the Tax Court could have been computed without partner-level proceedings to determine the affected-items questions concerning outside bases, we are unable to uphold the court's determination of the penalty issues. While it may be that some penalties could have been assessed without partner-level computations, we cannot affirm a decision that has not yet been made. Therefore, we vacate the opinion of the Tax Court on the penalties imposition and computation. It may be that upon remand, a determination can be made for some

portion of the penalties, but neither party has briefed that question before us.

III. Conclusion

For the reasons set forth above, the decision of the Tax Court is affirmed in part and reversed in part. We affirm the decision of the court that it had jurisdiction to determine the sham nature of the partnership entity. We reverse the decision of the Tax Court insofar as it asserted jurisdiction over the outside-basis issues. We vacate and remand for further proceedings the Tax Court's decision on the penalties question.

So ordered.

United States Court of Appeals for the Federal Circuit

2000-5045

WALTER PROCHORENKO and OKSANA PROCHORENKO,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 98-CV-754T, Judge Nancy B. Firestone.

DECIDED: March 23, 2001.

Dennis N. Brager, Law Offices of Dennis N. Brager, A.P.C., of Los Angeles, CA, argued for plaintiffs-appellants.

Teresa E. McLaughlin, Attorney, Tax Division, Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief was *Teresa T. Milton*, Attorney.

Before LOURIE, SCHALL, and BRYSON, Circuit Judges.

LOURIE, Circuit Judge.

Walter and Oksana Prochorenko appeal from the decision of the United States Court of Federal Claims granting summary judgment in favor of the government and denying the Prochorenkos' motion for summary judgment on their claim for a refund of federal income taxes paid for the years 1982 through 1985. *Prochorenko v. United States*, 45 Fed. Cl. 494 (2000). Because we conclude that the Prochorenkos are not entitled to reduce their partnership tax liability based on the statutory right to a consistent settlement of "partnership items" under I.R.C. §6224(c)(2), we affirm.

BACKGROUND

After acquiring a limited partnership interest in Syn Fuel Associates in 1982, the Prochorenkos claimed deductions on their joint federal income tax returns for 1982 through 1985 based on their proportional share of the partnership losses. *Id.* at 495. After conducting an audit, the Internal Revenue Service ("IRS") disallowed the claimed partnership losses and issued a Final Partnership Administrative Adjustment ("FPAA") pursuant to the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub.L. No. 97-248, 96 Stat. 324 (1982). *Id.* at 495-96. Subsequently, several partners elected to challenge the FPAA in the United States Tax Court. *Id.* at 496. While the appeal in the Tax Court was still pending, several other partners entered into an agreement with the IRS ("the Craig settlement") under terms that were more favorable to the settling partners than those

in the FPAA. *Id.* Dennis Brager, the attorney who represented the settling partners, also represented other Syn Fuel partners who did not enter into the Craig settlement. *Id.*

On March 31, 1993, the Tax Court upheld the FPAA. *Peat Oil & Gas Assocs. v. Comm'r,* 100 T.C. 271, 1993 WL 95582 (1993). On April 30, 1993, Brager sent a letter to all of the non-settling partners that he represented, including the Prochorenkos, informing them of the Tax Court's decision and advising them to request settlements under terms consistent with the Craig settlement. *Prochorenko,* 45 Fed. Cl. at 496. Under I.R.C. §6224(c)(2), if the IRS enters into a settlement agreement "with respect to partnership items" with any partner, other partners have the right to request terms that are consistent with those contained in the previous settlement agreement. Such requests must be made within 150 days from the day on which notice of the FPAA is mailed to the tax matters partner, or within sixty days from the day on which the prior settlement agreement was entered into. I.R.C. §6224(c)(2); Treas. Reg. §301.6224(c) 3T (2000). In his letter, Brager instructed any clients who were interested in requesting such a settlement to do so by May 10, 1993, which was sixty days after the date that the IRS gave notice of the Craig settlement. *Prochorenko,* 45 Fed. Cl. at 497. The Prochorenkos did not make such a request. *Id.* Instead, the non-settling partners (which by operation of law included the Prochorenkos) appealed to the United

States Court of Appeals for the Second Circuit, which affirmed the Tax Court's decision. *Ferguson v. Comm'r,* 29 F.3d 98 (2d Cir.1994).

After paying the disputed taxes, the Prochorenkos learned that another Syn Fuel partner, Anthony Colitti, and his wife had entered into an agreement with the IRS ("the Colitti settlement") on August 17, 1997, under terms that were similar to those granted in the earlier Craig settlement. *Prochorenko,* 45 Fed. Cl. at 497. On May 4, 1995, the Colittis wrote to the IRS seeking "to formalize the agreement that they believe[d] that they entered into." *Id.* at 498. According to the Colittis, they had signified their acceptance of the IRS's earlier settlement offer in 1993. *Id.* Although the IRS disputed the Colittis' contentions as to whether they had timely requested such a settlement, the IRS eventually agreed to settle with the Colittis "through administrative grace only." *Id.* On October 3, 1997, within sixty days from the date the Colitti settlement was finalized, the Prochorenkos filed a request with the IRS for a settlement agreement with terms consistent with the Colitti settlement, which the IRS denied. *Id.* The Prochorenkos subsequently filed tax refund claims for the years 1982 through 1985, based on their request for a consistent settlement, which the IRS also denied. *Id.*

Thereafter, the Prochorenkos filed this suit in the Court of Federal Claims. *Id.* The government filed a motion for summary judgment, and in the

alternative, moved for dismissal for lack of jurisdiction. The Prochorenkos filed a cross-motion for summary judgment. The court granted summary judgment in favor of the government, concluding that the Prochorenkos had failed to state a claim upon which relief could be granted, and denied the Prochorenkos' corresponding cross-motion. *Id.* at 501. The court concluded that the Prochorenkos were not entitled to a reduction of their partnership tax liability based on the Colitti settlement. *Id.* at 495. The court explained that the Colitti settlement did not trigger the right to a consistent settlement under I.R.C. §6224(c)(2) because it was not a settlement "with respect to partnership items." *Id.* at 501. The Prochorenkos now appeal to this court. We have jurisdiction pursuant to 28 U.S.C .A §1295(a)(3) (West Supp.2000).

DISCUSSION

We review the Court of Federal Claims' grant of a motion for summary judgment "completely and independently, construing the facts in the light most favorable to the non-moving party." *Am. Airlines, Inc. v. United States,* 204 F.3d 1103, 1108 (Fed.Cir.2000) (quoting *Good v. United States,* 189 F.3d 1355, 1360 (Fed.Cir.1999)). In reviewing a denial of a motion for summary judgment, we give considerable deference to the trial court, and "will not disturb the trial court's denial of summary judgment unless we find that the court has indeed abused its discretion." *SuntTiger, Inc. v.*

BluBlocker Corp., 189 F.3d 1327, 1333 (Fed.Cir.1999). Summary judgment is appropriate only when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. *Id.* When both parties move for summary judgment, the court must evaluate each motion on its own merits, resolving all reasonable inferences against the party whose motion is under consideration. *McKay v. United States,* 199 F.3d 1376, 1380 (Fed.Cir.1999). If there are no material facts in dispute precluding summary judgment, our task is to determine whether the judgment granted is correct as a matter of law. *Bankers Trust N.Y. Corp. v. United States,* 225 F.3d 1368, 1372 (Fed.Cir.2000).

A. *Jurisdiction*

Before we reach the merits of the Prochorenkos' appeal, we must first address the government's contention that the Court of Federal Claims lacked jurisdiction over the Prochorenkos' tax refund claim because the United States has not waived its sovereign immunity with respect to such claims. The Court of Federal Claims declined to decide this issue in light of its conclusion that the Prochorenkos failed to state a claim for which relief could be granted. Establishment of jurisdiction, however, is a prerequisite to a decision on the merits. We will therefore determine first whether the Court of Federal Claims had jurisdiction over the Prochorenkos' claim.

The government contends that the Prochorenkos' suit is barred by I.R.C. §7422(h), which precludes suits "for a refund attributable to partnership items." The government argues that the Prochorenkos' claim does not fall within the scope of I.R.C. §6230(c)(1)(B), which allows a partner to file a refund claim for overpayments "attributable to the application to the partner of a settlement." The government contends that this express exception only applies to a partner who is bound by a settlement that the IRS refuses to honor. The Prochorenkos respond that the Court of Federal Claims had jurisdiction to hear their claim under I.R.C. §6230(c)(3), which permits a partner to bring suit if a refund claim under I.R.C. §6230(c)(1)(B) is not allowed. The Prochorenkos contend that I.R.C. §6230(c)(1)(B) allows a partner to file a refund claim for an overpayment due to the failure of the IRS to make a refund based on the application of a settlement entered into with another partner.

We conclude that the Prochorenkos' claim is not barred by I.R.C. §7422(h) because it is not a claim "for a refund attributable to partnership items." Section 7422(h) provides as follows:

> (h) Special rule for actions with respect to partnership items.--No action may be brought *for a refund attributable to partnership items (as defined in section 6231(a)(3)*) except as provided in section 6228(b) or section 6230(c).

I.R.C. §7422(h) (emphasis added). Section 6231(a)(3), which is located in the subchapter of the Internal Revenue Code that deals with the tax treatment of partnership items, expressly defines the term "partnership items" as follows:

> (3) Partnership item.--The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A *to the extent regulations prescribed by the Secretary provide that,* for purposes of this subtitle, *such item is more appropriately determined at the partnership level than at the partner level.*

I.R.C. §6231(a)(3) (emphasis added).

> Items that are "more appropriately determined at the partnership level than at the partner level and therefore are partnership items" are specifically set forth in the applicable regulation. Treas. Reg. §301.6231(a)(3)- 1(a) (2000). Under this regulation, "partnership items" include items such as the income, gains, losses, deductions, and credits of a partnership, *id.,* but do not include an individual partner's right to request a consistent settlement under I.R.C. §6224(c)(2), *see Monti v. United States,* 223 F.3d 76, 82 (2d Cir.2000). As the Second Circuit explained in *Monti:*

> One partner's right to settlement terms consistent with those granted to another partner is not a partnership item, because the question posed requires consideration of the relationship between one partner's situation and another's and the individual's, rather than the partnership's, communications with the IRS. The facts needed to determine whether consistent terms were offered are facts about the partner, not facts about the partnership.

Id. at 82-83. Accordingly, we conclude that a partner's right to a consistent settlement under I.R.C. §6224(c)(2) is not itself a "partnership item."

While it is true that the Prochorenkos were seeking a refund of partnership taxes, their refund was not "attributable to partnership items." Rather, it was based on their claimed right to a consistent settlement under I.R.C. §6224(c)(2). The Prochorenkos claimed that they were entitled to a reduction of their partnership tax liability based on a settlement that the IRS had entered into with another partner. Whether or not the Prochorenkos were entitled to such a reduction is an issue that is entirely dependent on their own unique factual circumstances, and has no effect on and is not affected by the tax liability of any of the other Syn Fuel partners. Accordingly, this is not the type of issue that is "more appropriately determined at the partnership level." Treas. Reg. §301.6231(a)(3)-1(a). Construing the phrase

"attributable to partnership items" so broadly as to cover claims that depend on the unique circumstances of an individual partner, and that only affect that partner, would be contrary to the system of separate treatment of partnership items and nonpartnership items established by Congress in enacting TEFRA. *Monti*, 223 F.3d at 82 (explaining that while, at some level of generality, most refund claims for partnership taxes can be characterized as a refund "attributable to partnership items," to treat claims that are entirely dependent on facts peculiar to an individual partner would blur the distinction between proceedings involving partnership items and those involving nonpartnership items, and would be contrary to the system established by Congress in enacting TEFRA). We therefore conclude that the Prochorenkos' claim is not for a refund "attributable to partnership items," and that the Court of Federal Claims had jurisdiction to hear the Prochorenkos' claim.

B. *The Colitti Settlement*

We next address the parties' arguments concerning whether the Prochorenkos are entitled to a consistent settlement under §6224(c)(2). The Prochorenkos argue that they are entitled to a settlement consistent with the Colitti settlement, which they characterize as a settlement "with respect to partnership items" that reduced the Colittis' tax liability for partnership items. The Prochorenkos contend that the Court of Federal

Claims erred in determining that the Colitti settlement was merely a settlement of the Colittis' claim that they were entitled to a consistent settlement under I.R.C. §6224(c)(2). The Prochorenkos also contend that the IRS had the authority to settle "partnership items" with the Colittis under I.R.C. §§6404(a) and 6224(c)(2), and that even if the IRS did not have such authority, the Colitti settlement still triggered the Prochorenkos' right to request a consistent settlement under I.R.C. §6224(c)(2) because it was voidable and not void *ab initio*.

The government responds that the Prochorenkos are not entitled to a consistent settlement under I.R.C. §6224(c)(2) because the Colitti settlement was not a settlement "with respect to partnership items." The government asserts that the Colitti settlement was instead a settlement of the Colittis' claim that they were entitled to terms consistent with the earlier Craig settlement, based on their timely election in 1993. The government argues that the IRS compromised with the Colittis based on their unique factual claim, and not on a claim that related to the substantive treatment of Syn Fuel partnership items.

We agree with the government that the Prochorenkos are not entitled to a consistent settlement under I.R.C. §6224(c)(2) because the Colitti settlement was not a settlement agreement "with respect to partnership items." We reach this

conclusion based upon the plain language of the relevant statutes. *See Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980) ("[T]he starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive."). Section 6224(c)(2) provides in relevant part as follows:

> (2) Other partners have right to enter into consistent agreements.--If the Secretary enters into a settlement agreement with any partner *with respect to partnership items* for any partnership taxable year, the Secretary shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such agreement.

I.R.C. §6224(c)(2) (emphasis added). Thus, according to the plain language of the statute, whether the Prochorenkos are entitled to a consistent settlement under I.R.C. §6224(c)(2) depends on whether the Colitti settlement was a settlement "with respect to partnership items."

The Court of Federal Claims expressly determined that "[t]he undisputed evidence shows that the [Colittis] claimed that they sought a consistent settlement in 1993." *Prochorenko,* 45 Fed. Cl. at 501. The court noted that the Colittis

wrote to the IRS on May 4, 1995, seeking "to formalize the agreement that they believe[d] that they entered into by communicating their desire to accept the settlement offer to the attorney for the partnership." *Id.* at 498. The court further noted that although the IRS disputed the Colittis' contentions, the IRS eventually agreed to settle with the Colittis "on terms similar to the 'Craig settlement.' " *Id.* Thus, the record supports the court's determination that the Colitti settlement was a settlement of the Colittis' factual claim that they were entitled to terms consistent with the Craig settlement, based on their request in 1993, rather than a settlement of partnership items. In other words, the Colitti settlement specifically resolved the issue whether the Colittis had a right to a consistent settlement under I.R.C. §6224(c)(2), based on their unique factual circumstances.

In light of our earlier determination that a partner's right to a consistent settlement under I.R.C. §6224(c)(2) is not a "partnership item," we conclude that the Colitti settlement was not a settlement "with respect to partnership items." While the Colitti settlement effectively reduced the Colittis' tax liability for "partnership items," the Colitti settlement itself was not a settlement "with respect to partnership items" because it arose from a claim that was "entirely dependent on facts peculiar to a single partner." *Monti*, 223 F.3d at 82. Whether the Colittis had made a timely request for a settlement offer with consistent terms is a specific factual question that relates solely to the

Colittis, and does not relate to the substantive treatment of Syn Fuel partnership items. Accordingly, the Colitti settlement was not a settlement "with respect to partnership items" that triggered the rights of other partners to obtain a consistent settlement under I.R.C. §6224(c)(2).

In its decision, the Court of Federal Claims concluded that the Colitti settlement could not have been a settlement of partnership items that triggered the rights of other parties under I.R.C. §6224(c)(2) because the IRS did not have the legal authority to settle partnership items once a final judgment on a contested FPAA has been entered. However, having reached the conclusion that the Colitti settlement was not a settlement "with respect to partnership items" on grounds distinct from those relied on by the Court of Federal Claims, it is unnecessary for this court to reach the parties' arguments concerning that issue.

We note that the very same basis that provides for jurisdiction in this case, *i.e.*, that the Prochorenkos' claimed right to a consistent settlement under I.R.C. §6224(c)(2) is not itself a partnership item, also deprives the Prochorenkos of the right to a settlement consistent with the Colitti settlement, because that settlement was not a settlement "with respect to partnership items." The Prochorenkos could have requested a settlement consistent with the earlier Craig settlement, but they failed to do so within 150 days after notice was given to the tax matters partner,

or within sixty days after the date the settlement was entered into. *See* I.R.C. §6224(c)(2); Treas. Reg. §301.6224(c)-3T. Thus, the Prochorenkos were not entitled to a consistent settlement under I.R.C. §6224(c)(2).

The Prochorenkos contend that the Court of Federal Claims' determination, that the IRS had settled the Colittis' claim that they were entitled to a consistent settlement, is contrary to the record evidence because, *inter alia:* (1) the Colittis never claimed that they submitted a timely request to the IRS; and (2) the Colitti settlement had more favorable terms than the Craig settlement. We disagree. While the Colittis may not have specifically contended that they submitted their request directly to the IRS, it is undisputed that the Colittis did claim that they had timely requested a consistent settlement under I.R.C. §6224(c)(2) by communicating their acceptance of the IRS's settlement offer (*viz.*, the Craig settlement) to the attorney for the partnership. *Prochorenko,* 45 Fed. Cl. at 498. Whether or not the Colittis properly made such a request to the IRS does not alter the fact that they claimed that they were entitled to a consistent settlement, and that the Colitti settlement ultimately resolved that claim.

Likewise, although there may have been slight differences in the terms of the Colitti and Craig settlements, that does not negate the fact that the Colitti settlement originated from the Colittis'

factual claim that they were entitled to a settlement consistent with the Craig settlement. Furthermore, the Prochorenkos do not dispute the government's assertion that the differences between the Colitti settlement and the Craig settlement primarily concerned certain "nonpartnership items" (*i.e.*, penalties and tax-motivated interest), and that the IRS was not required to grant consistent settlement terms with respect to such items. Accordingly, none of the Prochorenkos' factual assertions contradict the Court of Federal Claims' determination that the Colitti settlement was a settlement of the Colittis' claim that they were entitled to a consistent settlement under I.R.C. §6224(c)(2).

We have carefully considered the Prochorenkos' other arguments concerning this issue, but find them lacking in merit.

C. *Discovery*

As a final matter, the Prochorenkos argue that the Court of Federal Claims abused its discretion in denying their request for further discovery. The Prochorenkos contend that they were entitled to discovery of all documents relating to the Colitti settlement, including evidence as to what the IRS staff believed that they were settling, because there was a material question as to the nature of the Colitti settlement. The government responds that the Court of Federal Claims properly exercised its discretion in denying the Prochorenkos' discovery request because further

discovery would not have altered the court's conclusion that the Prochorenkos were not entitled to a consistent settlement.

We agree with the government that the Court of Federal Claims did not abuse its discretion in denying the Prochorenkos' discovery request. First, an abuse of discretion standard is a difficult one to meet on appeal. No abuse has been shown here. Moreover, as explained above, the evidence of record supports the court's determination that the Colitti settlement was a settlement of the Colittis' claim that they were entitled to a consistent settlement under I.R.C. §6224(c)(2). Thus, given that the Colitti settlement was not a settlement of "partnership items," additional discovery would not have altered the court's conclusion that the Prochorenkos had no right to a settlement consistent with the Colitti settlement under I.R.C. §6224(c)(2).

CONCLUSION

For the above reasons, we conclude that the Prochorenkos are not entitled to reduce their partnership tax liability based on the statutory right to a consistent settlement of "partnership items" under I.R.C. §6224(c)(2). Accordingly, we

AFFIRM.

BRYSON, *Circuit Judge,* dissenting:

I would not reach the merits of this dispute but would hold that the Court of Federal Claims lacked

jurisdiction to entertain the Prochorenkos' claim. I therefore respectfully dissent on that issue.

The first step in the jurisdictional analysis is 26 U.S.C. §7422(h), which provides that no action may be brought "for a refund attributable to partnership items" except as provided in 26 U.S.C. §§6228(b) or 6230(c). The court holds that the Prochorenkos' claim is not barred by section 7422(h) because their claim is not "for a refund attributable to partnership items," but instead is for treatment consistent with that given to the taxpayers in the Colitti settlement. Although the matter is debatable, I would not characterize the Prochorenkos' claim in that way. To be sure, the Prochorenkos are asking to be treated consistently with the Colittis, but the tax items as to which they are seeking consistent treatment are partnership items. The Prochorenkos' tax liability, and thus their right to a refund if they are entitled to one, relates to the tax treatment of those partnership items. The substance of their claim is therefore "attributable to partnership items" in the ordinary sense of that phrase. The Seventh Circuit agrees with this analysis, *see Kaplan v. United States,* 133 F.3d 469, 473 (7th Cir.1998), although the Second Circuit does not, *see Monti v. United States,* 223 F.3d 76, 82 (2d Cir.2000). Because the Prochorenkos are seeking a refund that stems from the tax treatment of partnership items, I think the Seventh Circuit's interpretation of section 7422(h) in *Kaplan* is correct and the Second Circuit's interpretation in *Monti* is not.

In *Monti,* the court ruled that an action brought by non-settling partners seeking tax treatment consistent with that accorded to other partners did not fall within the bar of section 7422(h). The Second Circuit reasoned that the Montis' action was not "attributable to partnership items" because their asserted right to consistent treatment depended on facts specific to them and their dealings with the IRS rather than on facts general to the partnership. *Monti,* 223 F.3d at 82. That reasoning, however, would seem to apply as well to other actions brought by individual partners, such as actions claiming errors in the computations or application of partnership items to particular partners, *see* 26 U.S.C. §6230(c)(1), or actions seeking a refund when the Secretary decides to treat a particular partner's partnership items as non-partnership items, *see* 26 U.S.C. §6228(b). Yet such actions fall within the scope of section 7422(h) and are exempted from its ban only by express exceptions in section 7422(h). The fact that an action turns on facts specific to particular partners therefore does not keep it from being an action "for a refund attributable to partnership items," within the meaning of section 7422(h), as long as the tax issues on which the refund request is based arise from partnership items.

The Prochorenkos do not dispute that section 7422(h) is applicable to their claim; instead, they contend that the Court of Federal Claims has jurisdiction over their complaint because their claim falls within the express exception to section

7422(h) for claims brought under section 6230(c). That subsection provides in pertinent part that a partner may file a claim for a refund on the ground that "the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement...." The Prochorenkos interpret that language to provide an exception for claims based on the failure to give a partner the benefit of a prior partnership settlement. I disagree. Although the statutory language is not entirely clear on this point, it is most naturally interpreted to refer to claims in which the Secretary fails to make a refund or allow a credit in the proper amount based on a prior settlement that *has been* applied to the partner. The Prochorenkos contend that section 6230(c) also includes a claim for a refund that should have been paid based on a prior partnership settlement that *should have been* applied to the partner filing the claim, but the statutory language is not so broad. It refers to a refund "attributable to the application to the partner of a settlement," not to a refund attributable to the erroneous failure to apply a settlement to the partner. The narrower reading of section 6230(c)(1)(B) is not only more consistent with the statutory language, but it is also more in accordance with the title of the subsection, "Claims arising out of erroneous computations, etc." Consistent with the title, the subsection is most naturally read to apply to errors resulting from mistakes in applying the terms of a prior

settlement to the suing partner, not to the Secretary's refusal to make a prior settlement applicable to the suing partner at all. Because I am persuaded that the bar of section 7422(h) applies to the Prochorenkos' claim and that the exception to that bar in section 6230(c) does not, I would vacate the judgment in this case and remand with directions to dismiss the complaint for lack of jurisdiction.

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

2009-5010

WILLIAM H. SCHELL and RUBY G. SCHELL,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendants-Appellee.

Appeal from the United States Court of Federal Claims in 03-CV-2028 and 04-CV-907, Judge Francis M. Allegra.

ORDER

NOTE: This order is nonprecedential.

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

ORDER

A combined petition for rehearing and for rehearing en banc having been filed by the Appellants, and a response thereto having been invited by the court and filed y the Appellee, and the petition for rehearing and response, having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on April 15, 2010.

FOR THE COURT,

/s/ Jan Horbaly, lb

Jan Horbaly
Clerk

Dated: 04/08/2010

Stamped
Filed

cc: Thomas E. Redding
Arthur T. Catterall

U.S. Court of Appeals for
the Federal Circuit
April 08, 2010
Jan Horbaly
Clerk

SCHELL V US, 2009-5010
(CFC-04-CV-1743

CONSTITUTION OF THE UNITED STATES OF AMERICA

ARTICLE I, SECTION 8, CLAUSE 9

The Congress shall have Power . . . To constitute Tribunals inferior to the supreme Court; . . . .

. . . .

AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

INTERNAL REVENUE CODE (26 U.S.C.)

SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL

Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level.

SEC. 6222. PARTNER'S RETURN MUST BE CONSISTENT WITH PARTNERSHIP RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY

(a) IN GENERAL.—A partner shall, on the partner's return, treat a partnership item in a manner which is consistent with the treatment of such partnership item on the partnership return.

* * * *

SEC. 6223. NOTICE TO PARTNERS OF PROCEEDINGS.

(a) SECRETARY MUST GIVE PARTNERS NOTICE OF BEGINNING AND COMPLETION OF ADMINISTRATIVE PROCEEDINGS.—The Secretary shall mail to each partner whose name and address is furnished to the Secretary notice of—

* * * *

(2) the final partnership administrative adjustment resulting from any such proceeding.

* * * *

(d) PERIOD FOR MAILING NOTICE.—

* * * *

(2) NOTICE OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENT.—The Secretary shall mail the notice specified in paragraph (2) of subsection (a) to each partner entitled to such notice not later than the 60th day after the day on which the notice specified in such paragraph (2) was mailed to the tax matters partner.

* * * *

SEC. 6224. PARTICIPATION IN ADMINISTRATIVE PROCEEDINGS; WAIVERS; AGREEMENTS.

* * * *

(c) SETTLEMENT AGREEMENT.—In the absence of a showing of fraud, malfeasance, or misrepresentation of fact—

(1) BINDS ALL PARTIES.—A settlement agreement between the Secretary and 1 or more partners in a partnership with respect to the determination of partnership items for any partnership taxable year shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year. . . .

(2) OTHER PARTNERS HAVE RIGHT TO ENTER INTO CONSISTENT AGREEMENTS.—If the Secretary enters into a settlement agreement with any partner with respect to partnership items for any partnership taxable year, the Secretary shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such settlement agreement. . . .

(3) TAX MATTERS PARTNER MAY BIND CERTAIN OTHER PARTNERS.—

(A) IN GENERAL.—A partner who is not a notice partner (and not a member of a notice group described in subsection (b)(2) of section 6223) shall be bound by any settlement agreement—

(i) which is entered into by the tax matters partner, and

(ii) in which the tax matters partner expressly states that such agreement shall bind the other partners.

* * * *

SEC. 6225. ASSESSMENTS MADE ONLY AFTER PARTNERSHIP LEVEL PROCEEDINGS ARE COMPLETED.

(a) RESTRICTION ON ASSESSMENT AND COLLECTION.—Except as otherwise provided in this subchapter, no assessment of a deficiency attributable to any partnership item may be made (and no levy or proceeding in any court for the collection of any such deficiency may be made, begun, or prosecuted) before—

(1) the close of the 150th day after the day on which a notice of a final partnership administrative adjustment was mailed to the tax matters partner, and

(2) if a proceeding is begun in the Tax Court under section 6226 during such 150-day period, the decision of the court in such proceeding has become final.

* * * *

SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS

(a) PETITION BY TAX MATTERS PARTNER.—Within 90 days after the day on which a notice of a final partnership administrative adjustment is mailed to the tax matters partner,

the tax matters partner may file a petition for a readjustment of the partnership items for such taxable year with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the Claims Court.

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER—

(1) IN GENERAL.—If the tax matters partner does not file a readjustment petition under subsection (a) with respect to any final partnership administrative adjustment, any notice partner (and any 5-percent group) may, within 60 days after the close of the 90-day period set forth in subsection (a), file a petition for a readjustment of the partnership items for the taxable year involved with any of the courts described in subsection (a).

* * * *

(5) TAX MATTERS PARTNER MAY INTERVENE.—The tax matters partner may intervene in any action brought under this section.

* * * *

(c) PARTNERS TREATED AS PARTIES.—If an action is brought under subsection (a) or (b) with respect to a partnership for any partnership taxable year—

(1) each person who was a partner in such partnership at any time during such year shall be treated as a party to such action, and

(2) the court having jurisdiction of such action shall allow each such person to participate in the action.

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

(2) TO FILE PETITION.—No partner may file a readjustment petition under subsection (b) unless such partner would (after the application of paragraph (1) of this subsection) be treated as a party to the proceeding.

* * * *

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates and the proper allocation of such items among the partners.

(g) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. With respect to the partnership, only the tax matters partner, a notice partner, or a 5-percent group may seek review of a determination by a court under this section.

(h) EFFECT OF DECISION DISMISSING ACTION.—If an action brought under this section is dismissed (other than under paragraph (4) of subsection (b)), the decision of the court dismissing the action shall be considered as its decision that the notice of final partnership administrative adjustment is correct, and an appropriate order shall be entered in the records of the court.

SEC. 6228. JUDICIAL REVIEW WHERE ADMINISTRATIVE ADJUSTMENT REQUEST IS NOT ALLOWED IN FULL.

(a) REQUEST ON BEHALF OF PARTNERSHIP.—

* * * *

(4) PARTNERS TREATED AS PARTY TO ACTION.—

* * * *

(B) PARTNERS MUST HAVE INTEREST IN OUTCOME.—For purposes of subparagraph (A), rules similar to the rules of paragraph (1) of section 6226(d) shall apply.

* * * *

SEC. 6229. PERIOD OF LIMITATIONS FOR MAKING ASSESSMENTS

(a) GENERAL RULE.—Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of—

(1) the date on which the partnership return for such taxable year was filed, or

(2) the last day for filing such return for such year (determined without regard to extensions).

(b) EXTENSION BY AGREEMENT.—

(1) IN GENERAL.—The period described in subsection (a) (including an extension period under this subsection) may be extended—

(A) with respect to any partner, by an agreement entered into by the Secretary and such partner, and

(B) with respect to all partners, by an agreement entered into by the Secretary and the tax matters partner (or any other person authorized by the partnership in writing to enter into such an agreement),

before the expiration of such period.

(2) COORDINATION WITH SECTION 6501(c)(4).—Any agreement under section

6501(c)(4) shall apply with respect to the period described in subsection (a) only if the agreement expressly provides that such agreement applies to tax attributable to partnership items.

* * * *

(d) SUSPENSION WHEN SECRETARY MAKES ADMINISTRATIVE ADJUSTMENT.—If notice of a final partnership administrative adjustment with respect to any taxable year is mailed to the tax matters partner, the running of the period specified in subsection (a) (as modified by other provisions of this section) shall be suspended—

(1) for the period during which an action may be brought under section 6226 (and, if an action an action with respect to such administrative adjustment is brought during such period, until the decision of the court in such action becomes final), and

(2) for 1 year thereafter.

* * * *

(f) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A

which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. The period described in the preceding sentence (including any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner

* * * *

SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

(2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.—

(A) Subchapter B shall apply to any deficiency attributable to—

(i) affected items which require partner level determinations, or

(ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) and are described in section 6231(e)(1)(B).

* * * *

(c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.—

(1) IN GENERAL.—A partner may file a claim for refund on the grounds that—

* * * *

(B) the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to

the application to the partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).

* * * *

(4) NO REVIEW OF SUBSTANTIVE ISSUES.—For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the settlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive.

* * * *

(l) COURT RULES.—Any action brought under any provision of this subchapter shall be conducted in accordance with such rules of practice and procedure as may be prescribed by the Court in which the action is brought.

SEC. 6231. DEFINITIONS AND SPECIAL RULES

(a) DEFINITIONS.—For purposes of this subchapter—

* * * *

(3) PARTNERSHIP ITEM.—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

(4) NONPARTNERSHIP ITEM.—The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.

(5) AFFECTED ITEM.—The term "affected item" means any item to the extent such item is affected by a partnership item.

(6) COMPUTATIONAL ADJUSTMENT.—The term "computational adjustment" means the change in the tax liability of a partner which properly reflects the treatment under this subchapter of a partnership item. . . . .

(7) TAX MATTERS PARTNER.—The tax matters partner of any partnership is—

(A) the general partner designated as the tax matters partner as provided in regulations, or

(B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership at the close of the taxable year involved (or, where there is more than 1 such partner, the 1 of such partners whose name would appear first in an alphabetical listing).

If there is no general partner designated under subparagraph (A) and the Secretary determines that it is impracticable to apply subparagraph (B), the partner selected by the Secretary shall be treated as the tax matters partner.

* * * *

(b) ITEMS CEASE TO BE PARTNERSHIP ITEMS IN CERTAIN CASES.—

(1) IN GENERAL.—For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date—

* * * *

(C) the Secretary enters into a settlement agreement with the partner with respect to such items, or

* * * *

(c) REGULATIONS WITH RESPECT TO CERTAIN SPECIAL ENFORCEMENT AREAS.—

(1) APPLICABILITY OF SUBSECTION.—This subsection applies in the case of—

* * * *

(E) other areas that the Secretary determines by regulation to present special enforcement considerations.

(2) ITEMS MAY BE TREATED AS NONPARTNERSHIP ITEMS.—To the extent that the Secretary determines and provides by regulations that to treat items as partnership items will interfere with the effective and efficient enforcement of this title in any case described in paragraph (1), such items shall be treated as non-partnership items for purposes of this subchapter.

* * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in

court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * *

SEC. 6621. DETERMINATION OF RATE OF INTEREST

* * * *

(c) INTEREST ON SUBSTANTIAL UNDERPAYMENTS ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—

(1) IN GENERAL.—In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the rate of interest established under this section shall be 120 percent of the underpayment rate established under this subsection.

(2) SUBSTANTIAL UNDERPAYMENT ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—For purposes of this subsection, the term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.

(3) TAX MOTIVATED TRANSACTIONS.—

(A) In general.—For purposes of this subsection, the term "tax motivated transaction" means—

(i) any valuation overstatement (within the meaning of section 6659(c)),

(ii) any loss disallowed by reason of section 465(a) and any credit disallowed under section 46(a)(8),

(iii) any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092),

(iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period, and

(v) any sham or fraudulent transaction.

* * * *

SEC. 7422. CIVIL ACTIONS FOR REFUND

(a) No suit prior to filing claim for refund.--No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

* * * *

(h) Special rule for actions with respect to partnership items.—No action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c).

SEC. 7441. STATUS

There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. The members of the Tax Court shall be the chief judge and the judges of the Tax Court.

SEC. 7442. JURISDICTION

The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926.

JUDICIARY AND JUDICIAL PROCEDURE (28 U.S.C.)

§1346. UNITED STATES AS DEFENDANT

(a) The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.

§1491. CLAIMS AGAINST UNITED STATES GENERALLY; ACTIONS INVOLVING TENNESSEE VALLEY AUTHORITY

(a)(1) The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. For the purpose of this paragraph, an express or implied contract with

the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.

(2) To provide an entire remedy and to complete the relief afforded by the judgment, the court may, as an incident of and collateral to any such judgment, issue orders directing restoration to office or position, placement in appropriate duty or retirement status, and correction of applicable records, and such orders may be issued to any appropriate official of the United States. In any case within its jurisdiction, the court shall have the power to remand appropriate matters to any administrative or executive body or official with such direction as it may deem proper and just. The Court of Federal Claims shall have jurisdiction to render judgment upon any claim by or against, or dispute with, a contractor arising under section 10(a)(1) of the Contract Disputes Act of 1978, including a dispute concerning termination of a contract, rights in tangible or intangible property, compliance with cost accounting standards, and other nonmonetary disputes on which a decision of the contracting officer has been issued under section 6 of that Act.

[(3) Repealed. Pub.L. 104-320, §12(a)(2), Oct. 19, 1996, 110 Stat. 3874]

Federal Regulations
Effective for the Tax Years in Issue

Treas. Reg. §301.6224(c)-3T CONSISTENT SETTLEMENTS (Temporary).

(a) IN GENERAL. If the Service enters into a settlement agreement with any partner with respect to partnership items, the Service shall offer to any other partner who so requests in accordance with paragraph (c) of this section settlement terms which are consistent with those contained in the settlement agreement entered into.

(b) REQUIREMENTS FOR CONSISTENT SETTLEMENTS. "Consistent" settlement terms are those based on the same determinations with respect to partnership items. Settlements with respect to partnership items shall be self-contained; thus, a concession by one party with respect to a partnership item may not be based upon a concession by the other party with respect to a nonpartnership item. Settlements shall be comprehensive, that is, a settlement may not be limited to selected items. The requirement for consistent settlement terms applies only if—

(1) The items were partnership items for the partner entering into the original settlement immediately before the original settlement, and

(2) The items are partnership items for the partner requesting the consistent

settlement at the time the partner files the request.

* * * *

Tax Court Rules

RULE 245. INTERVENTION AND PARTICIPATION

(a) Tax Matters Partner: The tax matters partner may intervene in an action for readjustment of partnership items brought by another partner or partners by filing a notice of election to intervene with the Court. . . . . See Code sec. 6226(b)(2); Rule 241(d)(3).

(b) Other Partners: Any other partner who satisfies the requirements of Code §6226(d) or 6228(a)(4)(B) may participate in the action by filing a notice of election to participate with the Court.

. . .

RULE 247. PARTIES

(a) In General: For purposes of this title of these Rules, the Commissioner, the partner who filed the petition, the tax matters partner, and each person who satisfies the requirements of Code §6226(c) and (d) or 6228(a)(4) shall be treated as parties to the action.

(b) Participating Partners: Participating partners are the partner who filed the petition and such other partners who have filed either a notice of election to intervene or a notice of election to participate in accordance with the provisions of Rule 245. See Code §§6226(c), 6228(a)(4)(A).

RULE 248. SETTLEMENT AGREEMENTS

* * * *

(b) Settlement or Consistent Agreements Entered Into by All Participating Partners or No Objection by Participating Partners:

(1) After the expiration of the time within which to file a notice of election to intervene or to participate under Rule 245(a) or (b), the Commissioner shall move for entry of decision, and shall submit a proposed form of decision with such motion, if—

* * * *

(B) the tax matters partner (if a participating partner) agrees to the proposed decision in the case but does not certify that no party objects to the granting of the Commissioner's motion for entry of decision.

* * * *

(c) Other Settlement and Consistent Agreements: If a settlement agreement or consistent agreement is not within the scope of paragraph (b) of this Rule, then—

(1) in the case of a participating partner, the Commissioner shall promptly file with the Court a notice of settlement agreement or notice of consistent agreement, whichever may be appropriate, that identifies the participating

partner or partners who have entered into the settlement agreement or consistent agreement;

. . . .

UNITED STATES TAX COURT

CANYON DESERT VINEYARDS, FREDERICK H. BEHRENS, Tax Matters Partner,	)	
Petitioner,	)	
	)	Docket No. 15054-91
v.	)	Judge Halpern
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to Rule 248(b) of the Tax Court Rules of Practice and Procedure and Respondent's Motion for Entry of Decision, it is

ORDERED AND DECIDED: That the following statement shows the adjustments to the partnership items of Canyon desert [*sic*] Vineyards for the taxable year 1985, as set forth below:

ADJUSTMENTS TO ORDINARY INCOME:

Partnership Item	As Reported	As Determined
Farming Expense Schedule F	$ 7,423,234.00	$ 3,915,283.00
Other Deductions	$ 195,665.00	$ 195,665.00
Capital Contributed	$ 3,570,500.00	$ 3,570,500.00

during the year

Liabilities (short-term)	$ 6,071,334.00	$ 195,318.00
Liabilities (long-term)	$ 331,711.00	$ 331,711.00

TAX PREFERENCE ITEMS:

Partnership Item	As Reported	As Determined
Qualified Investment Income	$ 13,419.00	$ 13,419.00
Qualified Investment Expense	$ 7,542,718.00	$ 1,357,689.00

[Page 2]

OTHER ADJUSTMENTS:

Partnership Item	As Reported	As Determined
Investment Interest Investment Income	$ 13,419.00	$ 13,419.00

That the foregoing adjustments to partnership income and expense are attributable to transactions which lacked economic substance, as described in former I.R.C. §6621(c)(3)(A)(v), so as to result in a substantial distortion of income and expense, as described in I.R.C. §6621(c)(3)(A)(iv), when computed under the partnership's cash receipts and disbursements method of accounting;;

That liabilities in the mount of $5,876,016 lack economic substance; and

That the assessment of any deficiencies in income tax that are attributable to the

adjustments to partnership items for the year 1985 is not barred by the provisions of I.R.C. §6229.

/s/ James S. Halpern, rz
Judge

Entered: JUL 19 2001

UNITED STATES TAX COURT

VISTA AG-REALTY PARTNERS, FREDERICK H. BEHRENS, Tax Matters Partner, Petitioner,	)	
v.	)	Docket No. 12539-90 Judge Halpern
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to Rule 248(b) of the Tax Court Rules of Practice and Procedure and Respondent's Motion for Entry of Decision, it is

ORDERED AND DECIDED: That the following statement shows the adjustments to the partnership items of Vista Ag-Realty for the taxable year ending November 30, 1986:

ADJUSTMENTS TO ORDINARY INCOME:

Partnership Item	As Reported	As Determined
Farming Expense Schedule F	$10,821,461.00	$ 5,909,843.00
Other Deductions	$ 290,917.00	$ 290,917.00
Capital Contributed	$ 5,500,000.00	$ 5,500,000.00

during the year		
Liabilities (short-term)	$ 8,782,178.00	$ 781,348.00
Liabilities (long-term)	$ 2,100,000.00	$ 2,100,000.00

TAX PREFERENCE ITEMS:

Partnership Item	As Reported	As Determined
Qualified Investment Expense	$1,001,254.00	$ 2,750,314.00

[Page 2]

That the foregoing adjustments to partnership income and expense are attributable to transactions which lacked economic substance, as described in former I.R.C. §6621(c)(3)(A)(v), so as to result in a substantial distortion of income and expense, as described in I.R.C. §6621(c)(3)(A)(iv), when computed under the partnership's cash receipts and disbursements method of accounting; and

That liabilities in the mount of $8,000,830 lack economic substance.

/s/ James S. Halpern, rz
Judge

Entered: JUL 19 2001

FORM 870-P(AD) (5-88)	DEPARTMENT OF THE TREASURY	IN REPLY
	INTERNAL REVENUE SERVICE	REFER TO
DATE: 12-20-96	SETTLEMENT AGREEMENT	MS 4550
	FOR PARTNERSHIP ADJUSTMENTS	122096-1905

TAXPAYER(S) NAME(S) AND ADDRESS	NAME OF PARTNERSHIP
WILLIAM H. & MARGARET N SCHELL	CANYON DESERT VINEYARDS
XXXXXXXXXXXXXXXXXXXXX	TIN: XX-XXXXXXX
XXXXXXXXXXXXXXXXXXXXX	TAX YEAR ENDED: 1985
TIN: XXX-XX-XXXX	

UNDER THE PROVISIONS OF SECTION 6224(C) OF THE INTERNAL REVENUE CODE, THE UNDERSIGNED OFFERS TO ENTER INTO A SETTLEMENT WITH RESPECT TO THE DETERMINATION OF PARTNERSHIP ITEMS OF THE PARTNERSHIP FOR THE YEAR SHOWN ON THE ATTACHED SCHEDULE OF ADJUSTMENTS. THE UNDERSIGNED, IN ACCORDANCE WITH THE PROVISIONS OF SECTION 6224(B) OF THE CODE, ALSO OFFERS TO WAIVE THE RESTRICTIONS ON THE ASSESSMENT AND COLLECTION OF ANY DEFICIENCY ATTRIBUTABLE TO PARTNERSHIP ITEMS (WITH INTEREST AS REQUIRED BY LAW) PROVIDED IN SECTION 6225(a).

THIS OFFER IS SUBJECT TO ACCEPTANCE FOR THE COMMISSIONER OF THE INTERNAL REVENUE SERVICE. IT WILL TAKE EFFECT AS A WAIVER OF RESTRICTIONS ON THE DATE IT IS ACCEPTED. UNLESS AND UNTIL IT IS ACCEPTED, IT WILL HAVE NO FORCE OR EFFECT.

IF THIS OFFER IS ACCEPTED FOR THE COMMISSIONER, THE TREATMENT OF PARTNERSHIP ITEMS UNDER THIS AGREEMENT WILL NOT BE REOPENED IN THE ABSENCE OF FRAUD, MALFEASANCE, OR MISREPRESENTATION OF FACT; AND NO CLAIM FOR REFUND OR CREDIT BASED ON ANY CHANGE IN THE TREATMENT OF PARTNERSHIP ITEMS MAY BE FILED OR PROSECUTED.

SIGNATURE OF TAXPAYER	DATE
/s/ William H. Schell	3-27-97
SIGNATURE OF TAXPAYER	DATE
/s/ Margaret N. Schell - Deceased	

IF THIS OFFER IS EXECUTED BY A TAX MATTERS PARTNER, PLEASE INCLUDE TITLE WITH THE SIGNATURE.

NOTE: THE EXECUTION AND FILING OF THIS OFFER WILL EXPEDITE THE ADJUSTMENT OF TAX LIABILITY.

IF THIS OFFER IS EXECUTED WITH RESPECT TO A YEAR FOR WHICH A JOINT RETURN OF A HUSBAND AND WIFE WAS FILED, IT MUST BE SIGNED BY BOTH SPOUSES, UNLESS ONE SPOUSE, ACTING UNDER POWER OF ATTORNEY, SIGNS AS AGENT FOR THE OTHER.

IF THE TAXPAYER IS A CORPORATION, THE OFFER MUST BE SIGNED WITH THE CORPORATE NAME FOLLOWED BY THE SIGNATURE AND TITLE OF THE OFFICER AUTHORIZED TO SIGN.

THIS OFFER MAY BE EXECUTED BY THE TAXPAYER'S ATTORNEY OR AGENT PROVIDED THIS ACTION IS SPECIFICALLY AUTHORIZED BY A POWER OF ATTORNEY, WHICH, IF NOT PREVIOUSLY FILED, MUST ACCOMPANY THIS FORM.

THE SUBMISSION OF THIS OFFER BY YOU AND THE ACCEPTANCE OF THE OFFER FOR THE COMMISSIONER MAY RESULT IN AN ADDITIONAL TAX LIABILITY TO YOU PLUS INTEREST AS PROVIDED BY LAW. iF THE RESULT IS A DECREAS IN TAX, THE AMOUNT OF THE DECREASE WILL BE SENT TO YOU WITH INTEREST AS PROVIDED BY LAW.

FOR INTERNAL REVENUE USE ONLY	DATE ACCEPTED FOR THE COMMISSIONER APR 28 1997 OFFICE	SIGNATURE /s/ <illegable> TITLE

Associate Chief

SALT LAKE CITY APPEALS OFFICE FORM 870-P(AD) (5-88)

Settlement Agreement For Partnership Adjustments

Schedule of Adjustments

Name of Partnership CANYON DESERT VINEYARDS Taxpayer Identifying Number: XX-XXXXXXX	December 31, 1985		
Detail of Adjustments to Ordinary Income			
Schedule F - Farm Losses	3,351,695		
Other Deductions	88,345		
Total Adjustments to Ordinary Income	3,440,040	0	0
Other Adjustments T P I - Qualified Investment Expense			
(1) Adjustment	(5,053,621)		
(2) As Reported	7,542,718		
(3) Corrected	2,489,097	0	0
Other Adjustments T P I - Qualified Investment Income			
(1) Adjustment	0		
(2) As Reported	13,419		
(3) Corrected	13,419	0	0
Other Adjustments T P I - Invest Interest - Invest Income			
(1) Adjustment	0		
(2) As Reported	13,419		
(3) Corrected	13,419	0	0

Remarks

FORM 870-P(AD) (5-88)	DEPARTMENT OF THE TREASURY	IN REPLY
	INTERNAL REVENUE SERVICE	REFER TO
DATE: 12-20-96	SETTLEMENT AGREEMENT	MS 4550
	FOR PARTNERSHIP ADJUSTMENTS	122096-1905

TAXPAYER(S) NAME(S) AND ADDRESS	NAME OF PARTNERSHIP
WILLIAM H. & MARGARET N SCHELL XXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXX TIN: XXX-XX-XXXX	VISTA AG-REALTY PARTNERS TIN: XX-XXXXXXX TAX YEAR ENDED: 1986

UNDER THE PROVISIONS OF SECTION 6224(C) OF THE INTERNAL REVENUE CODE, THE UNDERSIGNED OFFERS TO ENTER INTO A SETTLEMENT WITH RESPECT TO THE DETERMINATION OF PARTNERSHIP ITEMS OF THE PARTNERSHIP FOR THE YEAR SHOWN ON THE ATTACHED SCHEDULE OF ADJUSTMENTS. THE UNDERSIGNED, IN ACCORDANCE WITH THE PROVISIONS OF SECTION 6224(B) OF THE CODE, ALSO OFFERS TO WAIVE THE RESTRICTIONS ON THE ASSESSMENT AND COLLECTION OF ANY DEFICIENCY ATTRIBUTABLE TO PARTNERSHIP ITEMS (WITH INTEREST AS REQUIRED BY LAW) PROVIDED IN SECTION 6225(a).

THIS OFFER IS SUBJECT TO ACCEPTANCE FOR THE COMMISSIONER OF THE INTERNAL REVENUE SERVICE. IT WILL TAKE EFFECT AS A WAIVER OF RESTRICTIONS ON THE DATE IT IS ACCEPTED. UNLESS AND UNTIL IT IS ACCEPTED, IT WILL HAVE NO FORCE OR EFFECT.

IF THIS OFFER IS ACCEPTED FOR THE COMMISSIONER, THE TREATMENT OF PARTNERSHIP ITEMS UNDER THIS AGREEMENT WILL NOT BE REOPENED IN THE ABSENCE OF FRAUD, MALFEASANCE, OR MISREPRESENTATION OF FACT; AND NO CLAIM FOR REFUND OR CREDIT BASED ON ANY CHANGE IN THE TREATMENT OF PARTNERSHIP ITEMS MAY BE FILED OR PROSECUTED.

SIGNATURE OF TAXPAYER	DATE
/s/ William H. Schell	3-27-97
SIGNATURE OF TAXPAYER	DATE
/s/ Margaret N. Schell - Deceased	

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IF THE TAXPAYER IS A CORPORATION, THE OFFER MUST BE SIGNED WITH THE CORPORATE NAME FOLLOWED BY THE SIGNATURE AND TITLE OF THE OFFICER AUTHORIZED TO SIGN.

THIS OFFER MAY BE EXECUTED BY THE TAXPAYER'S ATTORNEY OR AGENT PROVIDED THIS ACTION IS SPECIFICALLY AUTHORIZED BY A POWER OF ATTORNEY, WHICH, IF NOT PREVIOUSLY FILED, MUST ACCOMPANY THIS FORM.

THE SUBMISSION OF THIS OFFER BY YOU AND THE ACCEPTANCE OF THE OFFER FOR THE COMMISSIONER MAY RESULT IN AN ADDITIONAL TAX LIABILITY TO YOU PLUS INTEREST AS PROVIDED BY LAW. IF THE RESULT IS A DECREAS IN TAX, THE AMOUNT OF THE DECREASE WILL BE SENT TO YOU WITH INTEREST AS PROVIDED BY LAW.

FOR INTERNAL REVENUE USE ONLY	DATE ACCEPTED FOR THE COMMISSIONER APR 28 1997 OFFICE	SIGNATURE /s/ <illegable> TITLE

Associate Chief

SALT LAKE CITY APPEALS OFFICE FORM 870-P(AD) (5-88)

Settlement Agreement For Partnership Adjustments

Schedule of Adjustments

Name of Partnership VISTA AG-REALTY PARTNERS Taxpayer Identifying Number: XX-XXXXXXX	November 30, 1986		
Detail of Adjustments to Ordinary Income			
Schedule F - Farm Losses	5,442,470		
Other Deductions	146,312		
Total Adjustments to Ordinary Income	5,588,782	0	0
Other Adjustments T P I - Qualified Investment Expense			
(1) Adjustment	(7,920,903)		
(2) As Reported	11,001,254		
(3) Corrected	3,080,351	0	0
Other Adjustments T P I - Qualified Investment Income			
(1) Adjustment			
(2) As Reported			
(3) Corrected	0	0	0
Other Adjustments T P I - Invest Interest - Invest Income			
(1) Adjustment			
(2) As Reported			
(3) Corrected	0	0	0

Remarks

Internal Revenue Service

memorandum

CC:WR:RMC:DEN:TL-12532-90
AMHarbutte

date: January 6, 2000

to: Ogden Service Center, TEFRA Technical Unit
attn: Diana Anderson
Kansas City Service Center,
Exam Support: TEFRA
attn: Jeanette Price

from: Regional Counsel, Western Region
Alice M. Harbutte,
Special Trial Attorney, Denver

---

subject: Project Partnership: AMCOR
Subject: 6230(c) Claims for Refund
and 6404(e) abatement
of interest

The purpose of this memorandum is to address some of the issues set forth in the refund claims that are currently being filed by the various Project partnership investors. We have been advised by the TEFRA Service Centers that approximately 2,000 such claims have been received to date. These claims encompass the following four issues: 1) adjustments to basis of a partnership interest,

. . . .

ISSUES

* * * *

2. Whether the Service should deny the Project investor's request for refund attributable to an adjustment in the basis of his partnership interest ["Basis" claim] . . . .

* * * *

Each of the different types of claims are discussed separately below.

"Basis" claim: Issue 2

The "basis" claims fall within the exception provided for at I.R.C. §6230(c)(1)(B). This section provides that a partner may file a claim for refund on the grounds that the Secretary failed to allow a credit or make a refund to a partner "attributable to" the application to the partner of a settlement.

Time for Filing "Basis" Claim:

Under the provisions of §6230(2)(B) as it pertains transcript of account "basis" claim, the statute provides that any claim under paragraph (1)(B) shall be filed within 2 years after the date the settlement was entered into. I.R.C. §6230(c)(2)(B)(i). Therefore, any claim requesting a refund with respect to gain that was reported by a Project investor on a Form 1040, for the year this investor sold his Project partnership interest (or otherwise disposed of such interest) must be filed within 2 years from the date the Form 870-P(AD) was signed on behalf of the Commissioner.

Merits of "Basis" Claim:

After whether or not a claim involving a basis adjustment was timely filed, the merits of the claim may then be looked at.

Under the terms of the Appeals settlement, the settled partner was required to report additional taxable income. This income was the result of the disallowance of a partion of the original partnership loss claimed by each partner. Therefore, the "basis" claim is "attributable to" the settlement of the partnership items and is allowable under I.R.C. §6230(c)(1)(B). Thus, a refund is proper, to the extent the taxpayer can substantiate the change to their basis in the partnership.

Substantiation of "Basis" Claim:

The Project investor must have settled their partnership items and must have paid the additional amount of tax required under the settlement. Proof that the investor entered into a settlement is the fully executed Form 870-P(AD). The Form 870-P(AD) will shoe the year for which the additional liability was agreed to. The individual investor's transcript of account for this taxable year should show the assessment of tax being made as a result of a computational adjustment relating to the Form 870-P(AD). The partner's basis will be increased, under the provisions of I.R.C. 705, by the amount his taxable income was increased as a result of the settlement.

To determine this amount, the computational adjustment, supporting schedules and the final computation that was mailed to the investor by the Service Center should be obtained.

* * * *

CONCLUSIONS

If the "basis" claim is the only refund claim relating to the Project partnership being made by the investor, then the claim should be allowed after substantiation is provided. However, if this investor has filed other claims for refund relating to the same partnership, then these other claims must first be resolved before processing any refund. The reason for this is that the other related claims may affect the calculation of the partner's basis.

AMCOR CLAIM INSTRUCTIONS

A claim may be filed to reflect the increase in your basis due to the sale of the partnership interest. In addition to the appropriate form, please send a copy of the tax return for the year in which the sale of the partnership interest was reported. If there is a capital loss carryover issue (you reported a $3,000 loss on Schedule D), we will need a claim for the year(s) that the loss was carried to. Include a copy of any examination reports that reflect the amount of losses disallowed or income increased.

In order to identify the claim as "AMCOR", **please annotate the top of the 1040X** with the following:

AMCOR Claim - forward to TEFRA Operations Stop 639

Send claims to:

BIRSC
PO Box 630
Holtsville NY 11742
Attn: TEFRA Operations
Stop 639